Supreme Court, U. S.
FILED
JAN 12 1978
MICHAEL RODAK, JR., CLERK

APPENDIX

Vol. III.—EXHIBITS

In The

Supreme Court of the United States

OCTOBER TERM, 1977

Nos. 77-452, 77-457, 77-551, 77-602

MOBIL ALASKA PIPELINE COMPANY, EXXON PIPELINE COMPANY, BP PIPELINES INC. and ARCO PIPE LINE COMPANY,

Petitioners,

—against—

UNITED STATES OF AMERICA, THE INTERSTATE COMMERCE COMMISSION, *et al.*,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITIONS FOR WRITS OF CERTIORARI FILED SEPTEMBER 22, OCTOBER 12, OCTOBER 25, 1977

CERTIORARI GRANTED NOVEMBER 28, 1977

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7/ 6/77	Flg. Petitioner's Application for Temporary Restraining Order—*Mobil Alaska*
7/ 6/77	Flg. Petitioner's Application for Interlocutory Injunction—*Mobil Alaska*
7/ 6/77	Flg. Petitioner's Memorandum in Support of their Applications for Interlocutory Injunction and Temporary Restraining Order—*Mobil Alaska*
7/ 8/77	Petition for Review of Order of ICC—*BP Pipelines*
7/11/77	Motion to Intervene of Sohio Pipe Line Co.—*Mobil Alaska*
7/11/77	Flg. Memorandum of Sohio Pipe Line Co. in Support of Petitioner's Application for Temporary Restraining Order—*Mobil Alaska*
7/11/77	Petition for Review of Order of ICC—*Exxon Pipeline*
7/11/77	Flg. Petitioner's Motion to Stay, Restrain and Suspend Order of I.C.C.—*BP Pipelines*
7/11/77	Flg. Petitioner's Memorandum in Support of Their Motion to Stay, Restrain and Suspend Order of I.C.C.—*BP Pipelines*
7/12/77	Flg. Motion of Exxon Pipeline Co. for Expedited Consideration or, in the Alternative, for a Stay Pending Review, a Memorandum in Support and Appendices to Memorandum in Support—*Exxon Pipeline*
7/12/77	Flg. Motion of State of Alaska for Leave to Appear as Party Pursuant to 28 U.S.C. § 2323, and § 2348, and Rule 15 of FRAP—*Mobil Alaska*
7/12/77	Flg. Reply of I.C.C. in Opposition to Petitioner's Applications for Interlocutory Injunction and Temporary Restraining Order—*Mobil Alaska*

DATE	
7/13/77	Petition for Review of Order of ICC—*ARCO Pipe Line*
7/13/77	Flg. Reply of Respondent, I.C.C., in Opposition to Petitioner's Motion to Stay, Restrain and Suspend Order of I.C.C.—*BP Pipelines*
7/13/77	Flg. Memorandum in Support of Motion of Respondent, U.S.A., to Dismiss Appeal—*Mobil Alaska*
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7/14/77	Motion for Injunction [with Memorandum in Support] of ARCO Pipe Line Co.—*ARCO Pipe Line*
7/14/77	Flg. Motion of Respondent, U.S.A., for Consolidation of Nos. 77-2412, 77-2421 and 77-2437 and to Dismiss Petitions —*all cases*
7/14/77	Flg. Telegram Confirmation of Interstate Commerce Commission as Requested by the Ct. with respect to earliest date projected for arrival of oil through pipeline to Valdez—*Mobil Alaska*
7/14/77	Flg. Telegram Confirmation of Mobil Alaska Pipeline Co. as Requested by Ct. with respect to earliest date projected for arrival of oil through pipeline to Valdez—*Mobil Alaska*
7/14/77	Flg. Telegram Confirmation of Exxon Pipeline Co. as Requested by Ct. with respect to earliest date projected for arrival of oil through pipeline to Valdez—*Exxon Pipeline*

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7/14/77 Flg. Telegram Confirmation of ARCO Pipe Line Co. as Requested by Ct. with respect to earliest date projected for arrival of oil through pipeline to Valdez—*ARCO Pipe Line*

7/15/77 Flg. Memorandum of U.S. in Support of Their Motion to Dismiss, also fld. in Nos. 77-2412, 77-2421, and 77-2437—*all cases*

7/18/77 Flg. Mobil Alaska's Reply Memorandum in Support of Application for Temporary Restraining Order and Interlocutory Injunction and Response to Motion to Dismiss. (Copies were mailed directly to Judges' home stations.)—*Mobil Alaska*

7/18/77 Flg. Motion of Amerada Hess for Entry of Appearance as a Party—*Mobil Alaska*

7/18/77 Flg. Exxon's Reply to Motion of USA for Consolidation and Motion to Dismiss (Copies sent directly to Judges' home stations.)—*Exxon Pipeline*

7/19/77 Flg. Reply of ICC in Opposition to ARCO's Application for Interlocutory Injunction, and Exxon's Motion for Expedited Consideration (Copies sent directly to judges' home stations.)—*ARCO Pipe Line and Exxon Pipeline*

7/19/77 Flg. State of Alaska's Supplemental Memorandum in Opposition to Application for TRO and Interlocutory Injunction and in Support of Motion to Dismiss filed by Respondent U.S. (Copies sent directly to home stations.)—*all cases*

7/19/77 Minute Entry: Oral arguments were held in Houston, Texas today on Cases 77-2392, 77-2412, 77-2421 and 77-2437 on the motion to dismiss, temporary restraining order and injunctive relief. The Court granted from the bench the motion to consolidate these cases as well as the motions of all parties to intervene. The motion to dismiss and temporary restraining order and injunctive relief motions were taken with the case. The Panel consisted of Judges Brown, Godbold and Roney. Arguing for Petitioners were: 1) Andrew J. Kilcarr (Mobil Alaska); 2) Richard

DATE

J. Flynn (Exxon); 3) Marvin Schwartz (BP) and 4) Robert Jordan who handled the rebuttal (for ARCO). Arguing for Respondents were: 1) Charles H. White, Jr. (ICC); 2) Donald A. Kaplan (D. of Justice); 3) Avrum Gross (Atty. Gen., Alaska) and 3) Yale Lewis (Arctic Slope)—*Mobil Alaska*

7/22/77 Flg. Suppl. Memorandum of State of Alaska in Opposition to Memorandum in Support of Petition fld. by Intervenor, Amerada Hess Pipeline Corp.—*all cases*

7/25/77 Flg. Motion of Union Alaska Pipeline Company to Appear as a Party—*Mobil Alaska and Exxon Pipeline*

7/29/77 Opinion of Court of Appeals dismissing cases: all motions to intervene granted; all motions for stay, suspension, injunction, etc. denied—*all cases*

8/15/77 Petition for Rehearing En Banc—*BP Pipelines*

8/17/77 Received certified list of all documents submitted to ICC—*all cases*

8/19/77 Flg. Petitioner's Motion for Stay of Mandate Pending Application for Certiorari—*Exxon Pipeline*

8/19/77 Flg. Petitioner's Motion for Stay of Order of Interstate Commerce Commission pending application for certiorari—*Exxon Pipeline*

8/25/77 Flg. Response of Respondent, I.C.C., in Opposition to Motion for Stay of Order of I.C.C. pending application for certiorari—*Exxon Pipeline*

8/29/77 Flg. Memorandum of Respondent, U.S.A., in Opposition to Motion for Stay—*Exxon Pipeline*

9/ 1/77 Flg. Response of State of Alaska in Opposition to Motions of Exxon Pipeline Co. for Stay of Mandate and Stay of Order of I.C.C.—*Exxon Pipeline*

9/ 8/77 Flg. Order Denying Exxon's Motion for Stay of Mandate and Denying Exxon's Motion for Stay of ICC's order. (JRB/PHR)—*Exxon Pipeline*

9/ 8/77 Flg. Order Denying BP's Petition for Rehearing and Denying Petition for Rehearing en banc. (JRB/PHR)—*BP Pipelines*

Date	
9/ 8/77	Judgment Issued as Mandate—*all cases*
9/26/77	Notice of Flg. of Cert. Pet. on 9-22-77—*Mobil Alaska and Exxon Pipeline*
10/17/77	Notice of Flg. of Cert. Pet. on 10-12-77—*BP Pipelines*
10/26/77	Flg. Copy of Supreme Ct. Order staying order of I.C.C. pending final disposition of petition for certiorari in Supreme Ct.—*Mobil Alaska*
11/ 1/77	Notice of Flg. of Cert. Pet. on 10-25-77—*ARCO Pipe Line*
12/ 2/77	Order of S.C. granted [certiorari] 11-28-77—*all cases*

INTERSTATE COMMERCE COMMISSION

Docket 36611

Title/Substance of Document

6/2/77 1. NOTICE: To Trans-Alaska Pipeline System owners. Requesting prompt filing of data concerning proposed rate levels and each company is asked to send a copy of its data submittal simultaneously to the State of Alaska.
[By] ROBERT L. OSWALD, Secretary (1 p.)

6/8/77 2. NOTICE: Requesting that any protests to the tariffs be filed by 6/13/77, and that replies to protests be submitted by 6/15/77.
[By] ROBERT L. OSWALD, Secretary (2 pp.)

6/13/77 3. SUPPLEMENTAL NOTICE: Advising the effective dates of tariffs filed by Sohio Pipe Line Company, BP Pipelines, Inc., and Mobil Alaska Pipeline Company have been postponed from 6/20/77 to 6/30/77, in view of these postponements, the filing dates set forth in the notice in item next above are modified, and that notice should be disregarded and requesting that protests to all of the tariffs now on file be submitted 6/15/77, and replies by 6/22/77. Parties desiring to participate in

Date

oral argument shall comply with rule 98 of the Commission's General Rules of Practice, by submitting a request for an allotment of time on or before 6/17/77.
[By] H. G. HOMME, JR., Acting Secretary (2 pp.)

6/14/77 4. PETITION: In aid of ICC Jurisdiction.
[By] STATE OF ALASKA
(by J. M. Cleary) (6 pp.)

6/15/77 5. REPLY: To the petition in item next above.
[By] SOHIO PIPE LINE COMPANY (4 pp.)

6/15/77 6. PROTEST/COMPLAINT
[By] STATE OF ALASKA
(by J. M. Cleary) (99 pp.)

6/15/77 7. PROTEST: And PETITION for Suspension and Investigation.
[By] BUREAU OF INVESTIGATIONS AND ENFORCEMENT, I.C.C.
(by E. D. Greenberg) (104 pp.)

6/15/77 8. PRELIMINARY STATEMENT
[By] TERRY F. LENZNER (representing Alaska Pipeline Commission) (267 pp.)

6/15/77 9. PETITION: AND COMPLAINT for suspension of initial rates and rules for transportation of petroleum via the Trans Alaska Pipeline System (TAPS) from Prudhoe Bay, Alaska, to Valdez, Alaska, and for an investigation thereof.
[By] ARCTIC SLOPE REGIONAL CORPORATION
(by W. W. Becker) (30 pp.)

6/15/77 10. PROTEST: And PETITION for suspension.
[By] UNITED STATES DEPARTMENT OF JUSTICE
(by P. J. Tomao) (29 pp.)

6/15/77 11. LETTER: Transmitting data, they believe, that the rate of earnings estimates will be produced by their initial tariff will not exceed any lawful criterion of the reasonableness of such earnings.
[By] SOHIO PIPE LINE COMPANY
(by J. T. Boltacz) (8 pp.)

BEST COPY AVAILABLE

Date

6/15/77 12. LETTER: Transmitting the basis for the computation of their tariff rate issued on 6/15/77.
[By] UNION ALASKA PIPELINE COMPANY
(by D. M. Schwartz) (4 pp.)

6/16/77 13. SUPPLEMENTAL PETITION: And COMPLAINT to the petition and complaint in item #13 above.
[By] ARCTIC SLOPE REGIONAL CORPORATION
(by W. W. Becker) (4 pp.)

6/17/77 14. ORDER: That the petition in item #4 above is *denied*.
[By] THE COMMISSION (Commissioners Murphy, Hardin, and Christian not participating) (1 p.)

6/17/77 15. ORDER: That an investigation is instituted; that the investigation in this proceeding shall include all matters and issues with respect to the lawfulness of the said schedules under the IC Act; and that the carriers parties to the schedules are made respondents to this proceeding.
[By] THE COMMISSION (Commissioners Murphy, Hardin, and Christian not participating) (2 pp.)

[Requests for oral argument time omitted]

6/17/77 21. Response to the notice in item #1 above.
[By] BP PIPELINES, INC.
(by D. A. Lucas) (23 pp.)

6/20/77 22. PROTEST: And PETITION for suspension and investigation.
[By] BUREAU OF INVESTIGATIONS AND ENFORCEMENT
(by E. D. Greenberg) (3 pp.)

6/21/77 23. LETTER: Transmitting a computation of the elements making up the determination of their proposed rate level.
[By] AMERADA HESS PIPELINE CORPORATION
(by A. S. Tabor, Jr.) (10 pp.)

6/22/77 24. NOTICE: Advising time allotments for Pipeline Companies and the protestants.
[By] H. G. HOMME, JR., Acting Secretary (2 pp.)

Date

6/22/77 25. REPLY: To the protests in item #'s 6, 7, 9, 10 and 13 above.
[By] MOBIL ALASKA PIPELINE COMPANY
(by A. J. Kilcarr) (67 pp.)

6/22/77 26. REPLY: To the protests in item #'s 6, 9 and 10 above.
[By] EXXON PIPELINE COMPANY
(by R. J. Flynn) (219 pp.)

6/22/77 27. REPLY: To the protests in item #'s 6, 7, 9 and 10 above.
[By] UNION ALASKA PIPELINE COMPANY
(by D. M. Schwartz) (25 pp.)

6/22/77 28. REPLY: To the protests in item #'s 6, 7, 9 and 10 above.
[By] PHILLIPS ALASKA PIPELINE CORPORATION
(by R. M. Shibley) (11 pp.)

6/22/77 29. REPLY: To the protests in item #'s 6, 7, 9 and 10 above.
[By] SOHIO PIPE LINE COMPANY
(by C. J. Lansdale) (34 pp.)

6/22/77 30. REPLY: To the protests in item #'s 6, 7, 9 and 10 above.
[By] AMERADA HESS PIPELINE CORPORATION
(by R. Moody, Jr.) (25 pp.)

6/23/77 31. REPLY: To the protests in item #'s 6, 7, 9 and 10 above.
[By] BP PIPELINES, INC.
(by J. Vickrey) (21 pp.)

6/23/77 32. SECOND SUPPLEMENT: To petition and complaint in item #'s 9 and 13 above.
[By] ARCTIC SLOPE REGIONAL CORPORATION
(by W. W. Becker) (8 pp.)

6/23/77 33. STATEMENT
[By] ALASKA PIPELINE SYSTEM
(by B. E. Benjamin) (13 pp.)

6/23/77 36. REPLY: To the protests in item #'s 6, 7, 9 and 10 above.
[By] ARCO PIPELINE COMPANY
(by R. E. Jordan, III) (198 pp.)

Date

6/27/77 37. LETTER: Addressed to Douglas Baldwin. requesting the Commission to reconsider its decision to close the special meeting scheduled for 6/28/77.
[By] UNITED PRESS INTERNATIONAL
(by G. Dillman) (2 pp.)

6/27/77 38. LETTER: Addressed to H. Gordon Homme. requesting. . . .
[By] DIANE B. COHN (on behalf of Edward K. DeLong, U.P.I.) (2 pp.)

6/27/77 39. LETTER: Addressed to A. Daniel O'Neal, requesting. . . .
[By] COMMON CAUSE
(by D. Cohen) (1 p.)

6/27/77 40. ORAL ARGUMENT: For testimony adduced at the oral argument held 6/27/77, see Volume 2 on page 9 herein.
[By] THE COMMISSION (208 pp.)

6/27/77 41. MOTION: For leave to file memorandum in reply to the responses of the carriers.
[By] THE DEPARTMENT OF JUSTICE
(by D. A. Kaplan) (9 pp.)

6/27/77 43. ORAL ARGUMENT EXHIBITS
[By] STATE OF ALASKA
(by J. M. Cleary) (10 pp.)

6/27/77 44. ORAL ARGUMENT EXHIBITS
[By] BUREAU OF INVESTIGATIONS AND ENFORCEMENT
(by E. D. Greenberg) (14 pp.)

6/27/77 TRANSCRIPT OF ORAL ARGUMENT: NO EXHIBITS IN EVIDENCE
(BY THE COMMISSION) (206 pp.)

7/1/77 45. THIRD SUPPLEMENTAL PETITION: And COMPLAINT.
[By] ARCTIC SLOPE REGIONAL CORPORATION
(by J. T. French) (4 pp.)

7/5/77 46. CONFERENCE: For testimony adduced at the conference held 7/5/77, see Volume 2 on page 9 herein.
(BY THE COMMISSION) (19 pp.)

Date

7/12/77 47. PROTEST/COMPLAINT: Seeking suspension and investigation.
[By] STATE OF ALASKA
(by J. M. Cleary) (10 pp.)

[End of Docket Entries in No. 36611 certified by the Secretary]

INTERSTATE COMMERCE COMMISSION

Docket I & S 9164

6/28/77 1. ORDER: That the operation of specified schedules is suspended, that the use thereof in interstate or foreign commerce be deferred from 6/30/77, and to and including 1/29/78, except as to I.C.C. 2, published by Amerada Hess, which bears a July 1 effective date and the operation of which is suspended to 1/31/78, unless ordered by this Commission; that an investigation is instituted into and concerning the lawfulness of the rates contained in the suspended schedules, as well as the interim schedules authorized to be filed, pursuant to section 15(1) and section 15(7), with a view to making such findings and orders in the premises as the facts and circumstances shall warrant; that the investigation in this proceeding shall include all matters and issues with respect to the lawfulness of the said rates under the IC Act; that the named carriers are authorized to file, upon not less than one day's notice, interim rates not exceeding specified amounts subject, however, to specified conditions; and that the said carriers are made respondents to this proceeding. (This order also embraces No. 36611).
BY THE COMMISSION (Commissioner Brown approves the order except insofar as it denied the motion of the Department of Justice for leave to file a response to the carrier's responses) (21 pp.)

7/8/77 3. PETITION: For Reconsideration.
[By] EXXON PIPELINE COMPANY
(by R. J. Flynn) (20 pp.)

Date		
7/15/77	8. NOTICE: A court action was instituted on or about 7/6/77, involving these proceedings before the U.S. Court of Appeals for the Fifth Circuit. [By] H. G. HOMME, JR., Acting Secretary	(1 p.)
7/15/77	9. NOTICE: A court action . . . on or about 7/8/77. . . .	
7/19/77	10. NOTICE: A court action . . . on or about 7/11/77. . . .	
7/26/77	11. NOTICE: A court action . . . on or about 7/13/77. . . .	
	[End of Docket Entries in No. I & S 9164 certified by Secretary]	

Transcript of Oral Argument Before Interstate Commerce Commission

BEFORE THE INTERSTATE COMMERCE COMMISSION

- x

In the Matter of: :

TRANS-ALASKA PIPELINES SYSTEM : No. 36611

- ORAL ARGUMENT - :

- x

Hearing Room B
Interstate Commerce Commission
12th & Constitution Ave., N. W.
Washington, D. C.

June 27, 1977

Met, pursuant to notice, at 9:00 a.m.

BEFORE:

COMMISSION MEMBERS PRESENT:

COMMISSIONER A. DANIEL O'NEAL, Chairman
COMMISSIONER CHARLES L. CLAPP, Vice Chairman
COMMISSIONER RUPERT L. MURPHY
COMMISSIONER DALE W. HARDIN
COMMISSIONER BETTY JO CHRISTIAN
COMMISSIONER GEORGE M. STAFFORD
COMMISSIONER ROBERT C. GRESHAM
COMMISSIONER ALFRED T. MAC FARLAND
COMMISSIONER VIRGINIA MAE BROWN

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P R O C E E D I N G S

The Clerk: The Interstate Commerce Commission is now in session to hear oral argument in Case Number 36611, Trans-Alaska Pipeline.

Commissioner O'Neal: Good morning.

We thank all of you for attending this oral argument. I want to make one announcement before we get into the remainder of the statement.

The Commission has just voted on two petitions to open the Commission conference on the Trans-Alaska Pipeline scheduled for tomorrow. By a majority vote, the Commission denied those petitions to open that conference, two Commissioners voting in the minority, the Vice Chairman and the Chairman.

Before the Commission for consideration at this time are the initial tariff filings of the eight pipeline companies which comprise the Trans-Alaska Pipeline system.

The rates proposed in these initial tariffs range from $6.04 per barrel to $6.44 per barrel and they bear effective dates of June 30, 1977 or later.

Protests have been filed by the State of Alaska, the Department of Justice, the Commission's Bureau of Investigations and Enforcement, and the Arctic Slope Regional Corporation, representing the Alaska natives.

Replies to the protests have been filed by the various individual pipeline companies and the service company, Alyeska.

This oral argument has been scheduled to provide the Commission and the parties with an opportunity to explore the issues involved.

You may be assured that the Commission will carefully study and evaluate all the pleadings which have been filed.

Accordingly, I ask you, in this oral argument, not to dwell too much on matters already set forth in the justifications, protests, or replies. Concentrate, if you will, on the major issues which must be resolved.

One final word about the ground rules, any Commissioner will be free to ask a question of counsel at any time. In order to avoid any unfairness, the parties will be kept to their alloted argument time. The pleadings that have been filed and the rebuttal or re-rebuttal periods, should provide adequate opportunity for each of you to have your arguments considered if that opportunity is not available on your first presentation.

Accordingly, unless you are answering a question when your time expires, I ask that you conclude your presentation immediately when the red light indicates that your time is up.

We'll begin now with the representatives of the pipelines. Would you come forward, please, and state your name, your full name, the name of the party or parties whom you represent?

Mr. Flynn: Mr. Chairman and members of the Commission, my name is Richard J. Flynn and I appear in this proceedings on behalf of Exxon Pipeline Company.

For the convenience of the Commission and to avoid unnecessary repetition, counsel representing the eight-owning pipelines have divided up the argument with respect to the common issues.

With respect to their individual rates, they rely primarily upon their written submissions.

Not all pipelines will be represented in this argument but all are represented in the room in the event questions arise concerning pipelines not presenting oral argument.

There are two, I guess, or three preliminary matters I'm raising on behalf of everyone.

This morning the Department of Justice handed us a lengthy reply to our reply. The Commission's rules do not permit such a reply to a reply. Counsel for the State of Alaska and for the Bureau of Investigation have handed us what they designate as oral argument exhibits. It is my understanding that most recently, in considering the efforts of the Milwaukee to secure inclusion in the Burlington Northern, this Commission has rejected such exhibits.

I haven't really studied Mr. Cleary's, but I note that the Bureau's presentations are not simply excerpts from their briefs, but represent a new set of calculations. And I state on behalf of the owning pipelines that we object to all three of those presentations.

Our appearance here today marks what is one of the last steps in what has been a very long and hard road for these pipelines in an effort to create a transportation system to bring crude oil from from Prudhoe Bay to --

Commissioner O'Neal: May I ask you a question?

Mr. Flynn: Yes.

Commissioner O'Neal: Do you plan to reserve any time for rebuttal? You should let us know what that is.

Mr. Flynn: We will all collectively reserve a half-hour for rebuttal.

Commissioner O'Neal: 30 minutes, okay.

Mr. Flynn: The opening arguments are intended to run no more than two hours.

We have constructed a transportation system to bring crude oil from Prudhoe Bay to Valdez where it can finally be moved by ships to the lower 48 states to meet some of the critical energy needs of this country.

We are here because even though the pipeline is physically capable of operating, none of the owners of that pipeline, each of which is a common carrier as a matter of law, can operate it without a tariff which has become effective.

As the Chairman mentioned, each has filed its own tariff, as they are required to do. They are scheduled to become effective in time to place crude oil on the ships when it reaches Valdez.

If the tariffs aren't effective, we cannot, as a matter of law, operate; we cannot accept the oil for transportation. Now, we are here really because there are four parties named by the Chairman, the Bureau of Investigations and Enforcement, the Department of Justice, the State of Alaska and the Artic Slope Regional Corporation don't like the rates we have filed.

They think their judgment as to a proper rate is better than that of the pipeline and they are asking you to substitute their judgment for the pipeline's to permit only lower rates which they propose to become effective.

If you should accept their remedy, in effect, you will have rejected the filings of the pipeline companies without any hearing because they don't propose that we have a hearing on our filed rates, they propose only a hearing on those lower rates.

Now, if you are going to reject our filings, you have certain standards to meet. Recently, in Associated Press versus the Federal Communications Commission, the Court of Appeals for the District of Columbia recognized that an agency does have the power in some cases and, in some cases perhaps a duty to reject a tariff that's unlawful on its face.

The rejected tariff that conflicts with the statute, with an agency regu[illegible] an order, or with a rate fixed in a contract sanc[illegible]ed by statute -- not sanctioned by statute, or a tariff can be rejected if it is unlawful unless you get

prior agency approval and you haven't gotten it. Those are about the only circumstances.

Now, other counsel will deal with the question of whether this Commission, in fact, has any power to suspend an initial rate. And other counsel will also deal with what I think is clear that the Commission does not have the power to impose a lower rate as a condition of not exercising its suspension power.

We will also, in later portions of this argument, deal with the questions of level of return and equitable considerations which arise out of the Commission's exercise of its suspension power.

It's my purpose to try to place this proceeding in context so we can understand, really, what we're dealing with here. In determining whether or not to exercise its suspension power, this Commission is not passing any judgment on whether or not the rates filed by these pipelines are just and reasonable; it can't.

Statute permits it to make that judgment only after it has had a full hearing. Nor is this Commission deciding that it will just let these pipelines file their rates and go right along.

The Commission can and I'm sure will institute an investigation of these rates whether or not it decides to suspend it. All we're deciding here is whether the tax rates, as

filed by the various pipelines, go into effect now so that the pipeline can operate, or whether they are held up while the Commission goes ahead and investigates those rates.

If the Commission doesn't suspend the rates, the pipeline's payments are, of course, subject to claims for repayment in the event the rates are ultimately found to be excessive.

If it does suspend, as I have said, we'll be sitting with an inoperable pipeline, losing vast sums of money, with no chance ever to recover it.

Now, the suspension power, as committed to this Commission's discretion, is subject only to the requirement that if it elects to exercise that power, it must state its reasons. And because it is a discretionary power and because it is so rarely exercised, there is not a great body of firm, fixed guidelines that state exactly how it's going to exercise that power.

But, given the nature of that power, it seems to us there are some things that the Commission should surely have in mind as it makes its decision.

In the first instance, the regulatory scheme which this Commission administers contemplates that rates will be initiated by carriers in the first instance. And in the case of initial rates, the carriers are presumed to have acted properly in establishing those rates.

Under the Act, in the case of an initial rate, the burden of proof is upon one who would challenge that rate. The carrier is not required to come in and prove that the rate is just and reasonable. The Protestants are required to prove that it is not.

I think another thing that should be kept in mind is that the suspension proceeding is, by its nature, a summary. No broad decisions are to be reached. It is not the occasion for attempting to resolve intricate, factual questions, disputed issues of fact. It is not the occasion for re-examining the methodology by which the Commission is going to determine its rates.

The Commission has acknowledged, really, that in the case of an initial rate, the suspension exercise is even more summary than in the case of an increased rate since it has, by general rule, shortened the notice period to 10 days.

I think that, because of the nature of these proceedings, you can save yourself a lot of time. The Protestants, most notably Alaska, have furnished you with a vast amount of material which they allege shows that the original costs are overstated.

We have not attempted to reply to that at this time. It is not the place to do it. The Commission is required, by statute, to undertake evaluation proceeding and, in that proceeding, to give consideration to original cost and, if Alaska and any other Protestant cares to make its argument about the cost of this project, they have a forum to do so.

It is also, I think, worth noting with respect to these charges -- I guess, I'll characterize these as -- that nobody asks you to do anything about them now. They are stated at

great length. They are put up with a one-sided statement, or very forward, I guess, on yesterday's television and this morning's newspaper, but you are not asked to do anything about that here. The Bureau correctly points out that those are difficult matters of fact which will have to be resolved after a hearing. And they are not a basis for suspension.

Again, by virtue of the nature of these proceedings, it is not the time to decide whether or not this Commission should depart from ratemaking based on valuation and go to a capitalization theory as the Department of Justice and Alaska press. That ratemaking method, whatever disputes we have with the Bureau about the details of how you apply the valuation process, that type of ratemaking has never been engaged in by this Commission. I doubt that it could, under the statute.

If it can, that's a matter that will be tested in another proceeding which is already under way, Ex Parte 308, where you are reconsidering methodology and you are considering rate of return.

The Artic Slope proposal would require a myriad of adjustments to original cost, to treatments of taxes, to depreciation. And I don't think that can be resolved on this proceeding.

Now, I think Alaska is certainly aware that this Commissic has already held very recently that what it is proposing here is not the proper subject even for a full-scale rate investigation. You announced that in the Williams Pipeline proceedings. Alaska is aware of that. Its counsel has attempted to get you to depart from valuation proceedings in respect to Williams Brothers for a great length of time, now, and you have turned him down.

Now, if you can't do it in a full-scale rate investigation surely you can't do it in a suspension proceeding. I don't think that you need to spend your time even considering the capitalization approaches advocated by the Department of Justice and by Alaska.

The one Protestant who clearly is attempting, at least, to follow valuation rate making is your Bureau of Investigation. And they recognize that, since you were given jurisdiction over pipelines -- provided that you will establish evaluation for each pipeline -- that that valuation would be prime facie evidence in all other proceedings under Part 1 of the Act, and that you will test rates by measuring them against the reasonable return on valuation.

Where we think the Bureau goes off the track is in

applying that. The principal dispute between the pipelines and the Bureau is that the pipelines contend that you should adhere to what we say has been the customary practice. Treat interest cost as an expense and apply your valuation limitations against net income after taxes.

The Bureau, on the other hand, says that the interest expense should be recovered in the return.

Now, as a matter of first impression, I suppose you might adopt either of those procedures. We submit that you adopted what we said, with the single exception of the Williams Brothers case, where you had a pipeline that really didn't care; and that its rates were so low, no matter which way you tested them, they were found to be just and reasonable.

And I don't think that represents a thoroughgoing reconsideration or an adoption of the methodology urged by the Bureau here.

We know what we've been doing. It seemed a little strange to me that I started out to try to deal with the Bureau's reliance on a 1935 case to demonstrate what was going on today. And I stopped, because that just seemed a little silly.

We know how we have fixed our rates. We have done it in the method we have said here. We think, if not you personally, you collectively, as a Commission, know how we have fixed our rates.

When asked by Congress to explain what the returns on

valuation were for the pipelines, you used exactly the method we did in making your own calculations; and furnished the Congress with returns on valuations for some 90 pipelines which you regulate, all of which were calculated by treating interest as an expense.

The Department of Justice has clearly understood that return on valuation is calculated, as we say it is. Only last year, Attorney General Levy, in dealing with the Loop and Seadock projects, described the Commission's methodology as exactly what we say it is, return on valuation is calculated on net income after taxes, after deducting interest as an expense.

The Federal Power Commission, quite recently, in dealing with an Alaskan gas pipeline, has indicated it knows how this Commission has acted in the past. That is, to calculate return on valuation on the basis of net income after taxes, after deducting interest as an expense.

Now, others will deal with the reasonableness of a return under whatever method you use here. I would say that the showings before you indicate that we have nothing to fear from the adoption of the Bureau's method. It's just, this isn't the place to do it. That's a proper subject for Ex Parte 308.

We think in a suspension proceeding, what you should do, is to look at the rates as filed to satisfy yourself that they have been calculated in accordance with the practice heretofore followed by this Commission, and if you find that they have, then stop, and exercise your discretion not to suspend.

The question of rates of return for an exotic pipeline and the Antarctic can't be decided in a suspension proceeding. The factual allegations about original cost can't be decided in a suspension proceeding.

We've put before you a rate calculated in the same manner we have been following consistently for years and we're entitled to have that rate tested, not some lower rate.

Thank you.

Commissioner Hardin: I have a question.

Mr. Flynn: Yes.

Commissioner Hardin: Your last statement there implies, at least, that the Commission then does have the power to suspend?

Mr. Flynn: The presentation made by Mobil Oil in its brief, I think, raises a very sustantial issue with respect to the Commission's power to suspend. That presentation shows that there is no place that you can say that it's been absolutely decided one way or another. But the background of the Act, which Mr. Kilcarr will deal with as soon as I sit down, does suggest that you do not have the power to suspend an initial rate.

What I have been saying has been on the assumption that you do and what you should do, assuming that you have that power.

Commissioner Hardin: If we do not have the power to suspend then would the carriers be in a position to file a rate, say, at $35 a barrel, and the Commission still could not suspend that?

Mr. Flynn: If you do not have that power, that would be

right. That would be Congress's decision.

Commissioner Hardin: And that is the position that I understand you are taking, that we do not have the power to suspend and they could file a rate at any level they want to, irrespective of the public interest.

Mr. Flynn: Pipelines are taking the position that you do not have the power to suspend an initial rate. But the horror case that you propose is not the one before us. The rates that we have before us were not calculated on that.

Commissioner Hardin: But it could be before us?

Mr. Flynn: Yes, I suppose it could be. It is not. And if that is a danger and if you do not have the power to suspend, perhaps to prevent that, you should seek that power.

But these rates meet both the tests that this Commission has applied and, in addition, are held down by the consent decree entered into in 1941, to an even lower return.

Commissioner Hardin: Thank you.

Mr. Kilcarr: May it please the Commission, my name is Andrew Kilcarr and I represent Mobil Alaska Pipeline Company and I will speak to the major, indeed, basic issue before the Commission and that is its authority to suspend its authority to establish interim rates.

And may I depart from my prepared remarks and respond to the Commissioner's last question in terms of the hypothetical $35 dollars. There is no doubt that the Commission has no authority to suspend; thus, the rate first and only filed by a carrier would prevail.

The $35 rate or some other horrible extension of that basic premise doesn't realistically apply, Your Honor, because the basic maximum rate on the oil has been set by the FEA. Secondly, you would not have rates like that on this system nor, I suggest, on any system that so departed from the basic costs and valuations for the simple reason that on this system, as on other pipeline systems, there are carriers who are not producers, who are on the pipeline as joint interest owners to produce revenue to attract shippers and at a prohibitive rate such as that, the shipper would not be attracted to the pipeline and I think that's --

Commissioner Hardin: Mr. Kilcarr, let me make clear why I asked the question. I used, obviously, a level of a rate way beyond anything that had been proposed or discussed.

Yet, there are allegations in this record that relate to the management and holding down of the cost. But what I am concerned with seeing developed here is precisely where we are going with respect to those kinds of allegations and that's what I would like to hear you address yourself to, on that particular point.

Mr. Kilcarr: Your Honor, with due respect, we have not allocated the argument, so I am not fortunate enough to have that responsibility. I did want to meet the hypothetical, however, and having said that, I would like to now return to what I consider to be, and others in this proceeding, the basic major issue and that is the authority of the Commission.

Let there be no doubt that the Protestants here have requested relief which would have the Commission, at the conclusion of this proceeding, cancelling the first and only tariffs filed by the carriers and then setting a new rate for the carrying of crude oil on the Trans-Alaska Pipeline System setting a new rate.

The word "suspension" and "interim rate", I suggest constitute camouflage because a rate would not be suspended, it would be emphatically and dramatically cancelled. And Mr. Flynn has just spoken to the implications of that. The Bureau's petition in protest says it quite explicitly.

Secondly, there is the matter of interim rate and there is, I respectfully suggest, no such beast in the legislation

which this Commission acts under. There is no interim rate basis in the legislation. There is a rate determination and prescription section, but there is no authority to establish interim rates.

Commissioner O'Neal: Isn't it true, Mr. Kilcarr, that the Commission has suspended initial rates in the past?

Mr. Kilcarr: The Commission has suspended initial rates, Your Honor; quite emphatically, yes. And I would suggest --

Commissioner O'Neal: Is there any court that has held that the Commission did not have that power?

Mr. Kilcarr: Pardon?

Commissioner O'Neal: Has any court held that the Commission did not have that power, that you are aware of?

Mr. Kilcarr: No, sir; no court has held that the Commission, in exercising the power in those cases, did not have the power. And the point to be emphasized is that those cases are entirely distinguishable from the case that presents itself to you this morning.

The difference is that in all of those cases, there existed a pre-existing rate. There was at work a change in that rate and it was the change proposal that was suspended. Some of the cases get into a declination of change versus initial rate but, in all cases, I suggest, there was an existing rate so that when the suspension occurred, there was no termination of transportation service during the period of

the dispute.

That, in addition, is another reason why, and another basis upon which it must be concluded that this Commission cannot suspend a first and only rate, because suspension of that rate leaves a total void.

There is nothing that comes in and keeps the service alive, if that rate is suspended.

Commissioner Hardin: But conversely then, on the premise Mr. Kilcarr, who would have the responsibility for the protection of the public interest?

Mr. Kilcarr: I believe, Your Honor, that you have the responsibility to protect the public interest and in exercise of that responsibility, you cannot, without additional reason, suspend this first and only tariff, because if you did, sir, the implications for the public interest would be horrendous. The Trans-Alaska Pipeline Act says that it is in the public interest that the early distribution of North Slope oil to the domestic markets occur. If you were to suspend this rate,these rates, filed by these carriers in the Trans-Alaska Pipeline System, there would be a void. And we --

Commissioner O'Neal: But suppose the Commission suspends, as it has done in some other cases, without prejudice,to refiling at a lower rate?

Mr. Kilcarr: It would be a suspension, Your Honor, and the void that you are coming close to has been very amply filled by the Protestants because they recognize the void; they recognize the implcations to the national economy and the national energy policy of the United States, so they are telling you that you should set an interim rate.

Commissioner O'Neal: But isn't this a void that could be filled rather easily if the pipelines merely file a rate that doesn't exceed whatever the Commission has viewed as one that they [illegible]ccept?

Mr. Kilc[illegible]: As to the simplicity, the mechanics, and the logistics of doing that, Your Honor, I can't deny that.

Certainly, it would be very simple. But, as to the legal implications, I would say that it would be absolutely unlawful. There is no doubt in terms of a long list of cases, beginning not necessarily with,the Moss versus Civil Aeronautics Board case, but certainly best exemplified in the Moss Case, that when a regulatory agency, such as this agency, attempts to suggest a rate, to prescribe a rate without conducting a full, evidentiary hearing, that its statutory authority requires, then that agency is engaging in economic cohersion.

Another case has called it blackmail, in that you have deprived the carrier of its right, under the Act and by common law, to set its initial rate when it enters into and becomes engaged in transportation. And, secondly, you have deprived the carrier of any option because the carrier has invested substantial monies in a system which will be shut down. In this case, it is $8 billion.

So that, if you, as a Commission, entered a suspension order and said -- well, however you said it,suggested a rate or suggested some maximum,or minimum or whatever, you would not only be directly foursquare within the Moss Case and all of the other cases that have decided that this can't be done, but you would, realistically, probably give some of these carriers no option.

They are sitting on top of $8 billion. They've got to have that start generating revenue. They are going to have to

do, probably, at least some of them what the Commission wants it to do. The courts recognize that for what it is. It is economic cohersion. Other courts have put a more apt label on it, Mr. Chairman. They have called it a "sham suspension order". The Bureau calls it a "conditional no suspend order". "Sham" is much more appropriate, because you are, realistically, not suspending. Realistically, you are telling them, "We're going to set the rate for you, or we're going to deprive you of your right to set the first and only rate on your pipeline". And when you do that, then, we'll go into our investigation and hearing.

Commissioner Hardin: Well, wouldn't that same principal be true in the prescription of a rate even if it is a changed rate?

Mr. Kilcarr: Well, it depends, Your Honor, on how the prescription occurs. Does it occur in accordance with Section 15(1) of the statute which says, right at the outset, "after full hearing the Commission may determine unreasonableness, unjustness and, then prescribe a rate".

Commissioner Hardin: Then it is your position that the exigencies of the situation that you have just described would not change that circumstance at all?

Mr. Kilcarr: Absolutely correct, Your Honor. There is only one basis upon which the Commission can prescribe a rate -- can determine a rate,and that is after a full hearing.

Yes, sir?

Commissioner MacFarland: No, I just want to be sure that I caught everything you said. Go ahead, sir.

Mr. Kilcarr: And I believe the words of that section, Section 15(1), are very significant, "after full hearing", "after". It establishes a mandatory condition precedent to the determination of, or and/or prescription of rates by this Commission. "Hearing", a record -- a record must be established for purposes of making the determination. There must be evidence, Your Honors, and in this proceeding there is no evidence before the Commission.

Your own rules state that explicitly. Rule 19 says that pleadings constitute evidence,but pleadings in petitions to suspend tariffs -- filings in petitions to suspend tariffs do not constitute pleadings, i.e., these filings do not constitute evidence. You have no evidence of unreasonableness, of unjustness as to these first and only filed tariffs. You have no basis upon which to make the determination that these Protestants would want you to make.

And finally, the word "full" is in there, "after full hearing", and that word signifies the implementation of the totality of judicial machinery, discovery by both sides, documentary and testimonial evidence, of record, and, indeed, the most basic of all record evidence, that which results from cross-examination,which we have not had to date, in

addition to everything else which we lack in this summary proceeding.

Consequently, there is no basis upon which this Commission can do anything by way of suggesting or affirmatively, for purposes of filling the void which would occur should you, on an equally unlawful basis, I respectfully suggest, suspend the tariffs that were filed by these carriers.

There would be an absolute void which could not be filled by suggestion or otherwise and the cases make that absolutely clear.

Let me also say that in this connection, where we are being asked to treat with, in a summary proceeding, the suspension of tariffs which we have a statutory right to have in operation during the period of investigation and hearing, and where you are being asked to set an interim rate, the Constitution of the United States has been, I suggest, absolutely invoked in these proceedings.

What you are being asked to do, I respectfully suggest, is to perform an unconstitutional act. You are being asked to deprive carriers of profiting without due process of law.

The cases in this area are in abundance. I would read, with your permission, only one extract from the Louisville Nashville Case in the Supreme Court. "A finding without evidence is arbitrary and baseless", said the Court, and went on to say, "it would mean that the Commission had the power possessed by no other officer, administrative body, or tribunal, under our government. It would mean that where rights depended

on facts", as they do here, "the Commission could disregard all the rules of evidence and capriciously make findings by administrative fiat", which you are being asked to do here.

Yes, ma'am?

Commissioner Christian: Mr. Kilcarr, do I understand then that your last argument is that regardless of how the statute reads at the present time, Congress would have no power to grant the Commission the power to suspend an initial rate?

Mr. Kilcarr: That is not the reach of my argument, Your Honor, and I apologize if you construed it so.

Commissioner Christian: Then what is the point of this last item?

Mr. Kilcarr: The point is that the statute captures the Constitutional guarantee of a hearing, of due process, and to deprive us of the hearing, and to set an interim rate, would be, in addition to a violation of the Act, it would be a violation of our Constitutional rights.

That is not to say that the Congress could not, as they did in 1910, extend, legislatively delegate to this Commission, the right to suspend first and only filed tariffs, which they have not done. They could probably delegate legislatively to this body the right to set interim rates, setting out a legislative rationale for that.

But that is not part of my argument. My argument is that

they have not done that. And to the extent that the Congress has guaranteed us a hearing, as does the Constitution, to do what the Protestants ask you to do, would not only violate the Act, it would violate these carriers Constitutional rights.

I would conclude my presentation, with Your Honor's indulgence, by speaking to the question raised in the Bureau's protest concerning a third part to the proposed order. The first part would be the suspension. The second part would be the suggestion or the setting of the interim rate. A third part would be that the Commission order the carrier to comply almost forthwith with an enormous subpoena.

But it's not a subpoena. It's a document demand that they would have you attach to your order and impose upon us, in direct contradiction of and contravention of the discovery rules of this Commission.

What they are trying to do, it seems clear, is to circumvent your discovery rules, to get you, as a body, to ignore your own rules of discovery and investigation.

We suggest that that is impermissible, that this is unfair and that it should not be indulged.

At the same time, we do state to the Commission that we will cooperate in any investigation that is going to be forthcoming from these proceedings, to the extent, hopefully, of even minimizing compulsory process and producing information from our resources, on a voluntary basis.

We would hope that the Protestants would act accordingly and cooperate also.

Our record of cooperation has been made clear to the Commissioners in the submission by the Alyeska Pipeline Company, where it demonstrates the production of documents and the number of interviews that have already been conducted on a informal, voluntary basis, with your accounting consultant, and not under compulsory process.

We would suggest that that is your record. We would commit to continuing. But we would not, in making that commitment, want to confuse anyone with the idea that we would accept and accede to this attachment to your order, requiring the production of this enormous amount of documents.

And with that I would conclude my presentation and thank you, Your Honors.

Commissioner O'Neal: Thank you.

Yes, sir, go ahead.

Mr. Jordan: Mr. Chairman, Commissioners, my name is Robert Jordan. I'm appearing this morning on behalf of ARCO Pipeline Company but, under the division of argument by counsel for the eight carriers, I've been asked to discuss some issues which have been raised with respect to rate of return.

Now, at the outset, I would like to make one thing perfectly clear, as the saying used to go here in Washington, the carriers here do not suggest, indeed, they actively oppose the concept that this Commission should try to establish new rate of return criteria in this suspension proceeding.

Mr. Flynn has already indicated to you that the proper place to do that is in Ex Parte 308. That proceeding was specifically broadened. It started out as an evaluation proceeding and the question of rate of return was consciously added to it. That is the proper place for there to be any breaking of new ground, any new departures, any new methods to be developed with respect to rate of return.

So, our position is that it would be wrong, as a matter of law, to do that in terms of trying to invoke rulemaking in a summary suspension proceeding. We also say it would be wrong as a matter of policy. It's the kind of thing the Commission ought not to do.

The Commission, just last December, said in the Williams Brothers' case that it was not going to take up issues like this in connection with the tariff filings of individual pipelines. That was a sound and proper decision by the Commission at that time. It remains sound and proper today.

Having said all that, I do wish to say this. The Protestants here have cited to this Commission in their papers certain inflammatory and wholely erroneous figures concerning a rate of return which the carriers would earn on their tax investments.

These, we feel, cannot be left standing without at least some comment. The fact that we're commenting does not represent any deviation from our basic position that this is not the time or the place to engage in new developments with respect to the Commissions's policy on the rate of return for oil pipelines.

Our view is that there is, in fact, a responsible range of debate about rate of return questions. We are all aware that different regulatory bodies do things slightly differently and it is not to say that there is not some leeway for looking at problems first one way and then the other.

The underlying, bottom line position, of course, must be that however you count the apples and however you count the oranges and however many lemons you throw in, the bottom line is that the carriers must be allowed to earn a fair rate

of return.

It is our view, our contention, that the approaches contended for by the Protestants here are really outside of that range of responsible debate about rate of return issues.

Now, let me give you some examples about the kinds of horror story numbers that have been floated in the Protestants' papers. The Antitrust Division protest talks of rate of return figures of 58 to 68 percent at a 10 percent equity which, commonly referred to, is a 90-10 debt equity ratio.

The Bureau of Investigations and Enforcement speaks of a 100 percent rate of return at seven percent equity, or what is commonly referred to as a 93-7 debt equity ratio. The State of Alaska speaks of 37.6 percent returns through 264 percent returns and, indeed, in the case of Mobil Alaska, suggests that the rate of return in that case is infinite.

I would note that this particular statement with respect to Sohio was contradicted by calculations in Alaska's own papers.

There is a basic flaw, a fundamental flaw, in all of these numbers and the flaw is this; that either unknowingly or deliberately -- and, frankly, I find it hard to think that it's unknowingly, given the qualifications of the people who appear on behalf of the Protestants -- all Protestants fail to note that in the case of the Trans-Alaska Pipeline System, this system could not have been built if the parent companies

of each of the pipeline subsidiaries had not either guaranteed the debt of those pipeline subsidiaries or furnished other equivalent forms of direct assistance in the way of financing. It could not have happened that way.

Now, what this means is that the capital structure of the pipeline's subsidiaries, these 90-10 debt equity ratios that are flouted before the Commission, 93-7 debt equity ratios, 85-15 debt equity ratios are wholly without economic significance. They are are artificial.

They could never exist without the parent guarantee or other similar parent support. The pipelines could never be established as independent entities with the debt equity ratios which appear on the books of these pipeline companies.

Now, who says so?

Commissioner Clapp: If the point, Mr. Jordan, that this project is a low risk operation makes any difference in connection with what you're saying, certainly a tremendous proven reserve of oil is being shipped. Are the pipelines the only foreseeable way to transport it? And the world is consuming oil at an unprecedented work rate.

To me, this is an extremely secure investment, which is conducive to a high ratio of debt to equity, and which lessens the danger that the guarantees provided by the companies will be necessary.

Mr. Jordan: Well, I'm going to answer that in a couple of ways. And I'm going to talk a little bit about the rate of return for minimum risk pipelines here in just a moment.

First of all, we reject the thought that this is a low risk pipeline. The companies here suffered, as has already

been noted, considerable difficulty just getting authority to build the pipeline. They suffered considerable difficulty during the building process.

This pipeline was started before the Arab embargo, when the companies first began planning this in 1968 and '69, so the initial commitments to this line were made long before anyone knew that the price of oil was going to escalate the way it has.

There are all sorts of natural problems in Alaska. The line has been designed to resist all of these. But there are earthquake problems, there are temperature problems, every conceivable form of difficulty.

And who knows? Who knows what the future holds with respect to oil? You're talking about a reservoir of oil in which people say we will be able to recover approximately 40 percent of 24 billion barrels in place of approximately 9.6 billion barrels. That's a prediction.

You've seen the studies, some of which were cited in the Protestants' papers, that show that it varies a great deal, depending on when you start taking gas, and how much gas you start taking, and at what rate you produce the oil.

To say that these are low risk pipelines, I think, is simply not accurate. This is a very risky venture. This is not your nice, easy pipeline across the flat part of Texas. It's coupled with all kinds of problems, not the least of which

is the overall uncertainty about the long term energy situation.

But I'll give you, in just a few minutes, the numbers that were derived with respect to low risk pipelines, if you want to use those as a baseline from which to build a proper rate of return.

Commissioner Brown: The quality in regard to this oil -- is this the highest quality oil there is in the world, or is it medium, or is it high?

Mr. Jordan: It's not the highest quality in the world because, to some extent, of its sulphur content. The oil business has a way of compensating for these by differentials.

In other words, you will take a bench mark crude oil, and that's worth so much. And the refinery will calculate that, if we're going to run this other oil, in relation to the bench mark, it's worth 50 cents less a barrel to us. This is not the highest quality oil.

You have to compare the two. You may have to put in special stainless steel or other sort of exotic metal facilities, in order to handle the extra sulphur content. Sulphur disposal becomes a problem.

There is material that would have to be removed from the oil in sort of a cleaning process, at the North Slope, before it even becomes of pipeline quality.

Commissioner Brown: Thank you.

Mr. Jordan: Let me tell you a little bit about what some

of the experts have said about these kind of crazy debt equity ratios that have been cited in the Protestants' papers.

As appendices to the Exxon response in this proceeding were the statements of Mr. Gary, an experienced investment banker with Morgan Standard, Inc., Dr. Solomon, professor of finance at the Stanford Business School.

Attached to the ARCO papers as Appendix D and E were the statements of Mr. Robert Houston of White Well, Dr. J. Rhodes Foster of Foster Associates.

Now, these gentlemen all have substantial experience in matters relating to rate of return and the capital structure of companies. And they all say that these debt equity ratios of the pipeline companies are simply without economic significance, that you just can't measure things that way. It just doesn't make any sense.

And what you have to do instead --

Commissioner Christian: Mr. Jordan, this same issue, this concept of computing rate of return on debt equity ratios, is considered by a number of regulatory agencies. Has this same argument, concerning the use of a parent company's debt equity ratio as opposed to that of the subsidiary itself, come up in other contexts before other agencies? And if so, what have those agencies ruled?

Mr. Jordan: I am sure it has come up in other contexts. Let me give you an example. The Federal Power Commission recommendation that was cited in the Exxon Papers at page XII-47, contains a table, and that table relates an overall pre-tax rate of return with equivalent after tax rates of return on equity at three different debt equity ratios. So, it very definitely recognizes that there is a great deal of significance to the debt equity ratio.

Now, they are talking there about lines that would be financed by the the entity, itself, and, eventually, a project financing, not something that somebody would come in and guarantee it and shift the risk.

The point is here, the parents have come in. They have assumed the risk. If those Arco Pipeline Bonds or those Exxon Pipeline Bonds are not paid off the by pipeline company, they are going to have to be paid by the parent, and that's the point.

But let me give you just one example from this Federal Power Commission table. This is a very recent publication. They suggested an overa ll pre-tax rate of return on the level of, let's say, 23 percent, would not be unreasonable, under the circumstances which they set forth there. And this is for the gas pipeline, by the way, coming down from Alaska through Canada, or otherwise.

The equivalent rate of return on equity, at a debt equity

ratio of 25-75 was 13.7 percent; at 50-50, it was 18 percent, and 75-25, it was 31 percent. So there definitely is a recognition.

Commissioner Christian: Was this issue discussed by the Power Commission in their presentation?

Mr. Jordan: Pardon?

Commissioner Christian: Was this particular issue discussed by the Federal Power Commission in its presentation? And, if so, what was its reasoning and what articulation do we have?

Mr. Jordan: I don't recall exactly in what context it was discussed by the Federal Power Commission, but I think the point is here that all three -- all four of the experts we have referred to here agree that you cannot look at a subsidiary, wholly-owned subsidiary, as a separate entity when it has a high debt equity ratio and when that high debt equity ratio is made possible by the fact that the parent has guaranteed the debt.

Commissioner Christian: I understand your argument, Mr. Jordan. Perhaps I didn't make my question clear. My question, specifically, was whether other regulatory agencies have had occasion to rule upon the argument that you are presenting to us here and, if so, what the rulings were and what the citations to the cases were?

Mr. Jordan: Well, frankly, we have not undertaken, in

this proceeding, to try to develop a history of what other agencies have done. As we said at the outset,we did not think it was appropriate to do that because this is a suspension proceeding and we don't think we ought to be putting on a full case with respect to the question of rate of return.

But let me tell you what one other expert has said in one other proceeding.

Commissioner Christian: May I take it that you either don't know the answer to my question or that the answer is no? I'm quite interested in the rest of your argument but I would also like an answer to my question.

Mr. Jordan: We have not undertaken to do a survey.

Commissioner Christian: That answers my question.

Mr. Jordan: There are 50 state regulatory jurisdictions and many of them have multiple regulatory bodies in them. Many of them adopt quite different approaches as the range is enormous. It just couldn't possibly be dealt with in something in the nature of a suspension proceeding.

Commissioner Christian: I hope that as this proceeding goes forward, then, if we do have an investigation, that all parties will develop this issue.

Mr. Jordan: I am sure that it will be developed. I think the proper place to develop it is in Ex Parte 308.

But I have mentioned four witnesses, four people who have proffered their expert opinion on this point. There is no

expert opinion on the other side on behalf of Protestants except one, and that one is Dr. Ileo. Dr. Ileo's calculations appear as an appendix to the protest of the State of Alaska.

Now, in March of 1977, Dr. Ileo was appearing as a witness for the staff of the Alaska Pipeline Commission in the Makisky Pipeline proceeding before that Commission, and he had occasion to discuss this very question of debt equity ratios. And think it is important enough,what he said there, that I read it to you. "It would incorrect, in my judgment, to treat Nakisky as if it were an independent company as long as it is fully owned by TeSoro. This is the case because all of the capital of Makisky was raised by TeSoro. Moreover, despite the fact that Makisky appears to be 100 percent debt financed by TeSoro" -- and here's the key language -- "it is truly financed by the consolidated capital structure of TeSoro, just as wholly-owned operating subsidiary of TeSoro. The fact that Makisky would never have been constructed without the financial backing of TeSoro, as reflected in the testimony of Makisky, clearly reflects this situation."

Now, he elaborates more on this on other pages. And his associate, as pointed out in the Exxon Papers, took a similar position there.

Let me give you a couple of examples of why this is important. You have been told about 93-7 debt equity ratios and even higher debt equity ratios, 90-10s and 85-15s.

Atlantic Richfield, on a consolidated basis, for example, it is the parent of Arco Pipeline, has a capital structure of approximately 64 percent equity. Not the kind of 7 percents and 10 percents, as you have been told about by Protestants.

Exxon shows in its papers a percentage of equity in its capital structure of approximately 71 percent.

Let's take these figures -- the only ones that have any real world economic significance -- and apply them to some of the numbers which have been quoted to you. The Antitrust Division talked about 58 to 68 percent return at 10 percent equity. Now, at 40 percent equity, below the figures I have just cited to you here, this turns out to be 14¼ to 17 percent rate of return on equity, not valuation, but equity. At 60 percent equity, this turned out to be 9.7 to 11.3 percent rate of return and at 70 percent equity, it turns out to be 8.3 to 9.7 percent return.

The Burueau, in its calculations, spoke of their alternative approach as affording a generous 20 percent return based on an assumption of 15 percent equity. But let's tinker with that assumption for a moment.

Let's assume the consolidated equity is not 15 percent but 30 percent; then we're talking about a 10 percent rate of return on equity. Let's assume that it's 45 percent; then we're talking about a 6 2/3 percent rate of return on equity. Let's assume that it's 60 percent within the range of the numbers I've given you. In that case, we're talking about a 5 percent return, assuming that you adopt the other elements of the Bureau's methodology.

Now, a couple of carriers involved here have applied the consolidated approach to the numbers that were furnished to the Commission to give you a better idea as to just how these things would come out if you applied that approach.

ARCO Pipeline, for example, used the overall Atlantic Richfield debt equity ratio of approximately 36-64, applied it to the valuation of the pipeline and calculated that portion of the valuation that was attributable to the equity of the consolidated enterprise.

Calculated that way, the rate of return on equity for 1978 came out to 12.2 percent. The rate of return for '77 through '81, which was the period for averaging used in arriving at ARCO's $6.04 tariff, came out to be 13.4 percent.

Now, EXXON, for example, as indicated at page 62 of its response, used Dr. Ileo's approach and applied it to their structure and came out with a rate of return on equity of 12.56 percent. So, the Commission has to understand that the numbers that have been cited to it just simply do not have reality.

You have to look at the consolidated financial situation of the pipeline subsidiaries and of parents. Now, the debt equity ratios of these companies are going to vary; they are not all the same, but you can do that.

Commissioner O'Neal: Let me ask a question here. It seems to me that -- okay -- the basic question here, really, is whether the parent companies -- whether anybody else, other than the parent companies, would assume the risk of financing this construction and that's the basis of the Vice Chairman's questions, I think. And you have cited some experts. Have the experts addressed that question, specifically?

Do we know whether anybody else would have financed this construction? Is this speculation? What is the basis for your arguments there?

Mr. Jordan: Well, the -- nobody was fighting for the privilege of coming forward to finance the Trans-Alaska Pipeline System [illegible], indeed, people --

Commissioner O'Neal: Did you seek any other techniques and go --

Mr. Jordan: -- other companies were given the opportunity to participate in the early days. A number of people were contacted. And there have been some changes and I think one company, Home Oil, dropped out at one stage but, except for that, it's been basically there have been changes in the names of entities and subsidiaries and so forth but, since the fairly early days, it's been basically the group that's involved here.

Commissioner O'Neal: Now, the group you're talking about are those who decided to build the pipeline. You're not talking about going to companies to financing houses or that sort of thing?

Mr. Jordan: That's right.

Commissioner O'Neal: You're talking about putting together this group to build the pipeline.

Mr. Jordan: That's right. And the financial experts that we've cited have all said that if you went to them, you couldn't do it with the kind of debt equity ratios we've talked about here. No one would purchase those bonds. The institutional purchases wouldn't touch them. Nobody in their right mind would accept the bonds of a pipeline company not guaranteed by the subsidiary.

Now, there may be a debt equity ratio point at which they would. Now, in the Ex Parte 308 proceeding, Mr. Gary and Dr. Solomon both considered the question of a proper rate of

return on valuation for so-called "minimum risk pipelines" and what they concluded was this; Mr. Gary said that 13 to 14 percent overall rate of return--not on equity now but on valuation--would be required to get the market to invest in a pipeline, a minimum risk pipeline.

Dr. Solomon said 13 to 13¼ percent, so the two numbers, the two ranges of numbers, are actually very close. Now, an important thing to note is that in arriving at these 13 and 14 percent figures, they used actually higher figures as applied to the equity portion. Mr. Gary used 15 to 16 percent but he assumed no more than 30 percent debt in doing that.

Dr. Solomon used 15¼ to 16 percent, but he assumed 25 percent debt in doing that. They then took the higher equity figures, averaged them with a rate of return which they thought was reasonable for a bond of this debt equity ratio and came out with these overall weighted averages in the 13 to 14 percent range. And these, of course, were perfectly consistent to the kinds of numbers I've been quoting to you, taken from the actual papers of the carriers here.

The other thing I must say -- and this gets back to the question which was raised earlier -- they both made it clear that they were talking about a minimum risk pipeline. What they're saying is, this is a flaw on rate of return. "We don't think you can finance any pipeline below this level

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because the market simply will not accept this rate of return. There are alternative investments that offer much better opportunities and nobody is going to suggest --

Commissioner O'Neal: In deciding whether a pipeline is a low-risk or a high-risk pipeline, what kind of things do you look at? I mean, here you have a supply of oil that is going to be moved out of the Prudhoe Bay area by pipeline. There is no other way of moving it. Doesn't that mean, as far as making money, this seems like a low-risk operation? Certainly, the construction, you know, entails some problems. But I'm trying to get a grasp here of what your criteria is.

Mr. Jordan: Let's assume for a moment that we call it a low-risk operation and let's start with 13 to 14 percent as a floor on a rate of return on valuation, again, not equity, for that low-risk, minimum-risk pipeline, that Mr. Gary and Dr. Solomon are talking about.

The risks involved, in any sort of oil venture of this kind, are very sustantial. There are enormous capital expenditures which have to be made.

Let's look at it right now. We have the oil. There is considerable difficulty with respect to the disposition of some of the oil.

You've all read the stories about the potential oil glut on the West Coast. Regulatory delays may well impose some difficulties in terms of transporting that oil. If it can't be absorbed on the West Coast, it's got to be taken somewhere else. How's it going to get there? The regulatory authorities in California --

Commissioner O'Neal: Do you have any doubt that you are going to find a market for this oil?

Mr. Jordan: I don't have any doubt that the combination of the ingenuity of the companies and the facing of reality, ultimately, by the appropriate regulatory authorities, would bring about some sense.

But as a businessman, looking at the situation right now, I would have a very nervous stomach, particularly if I was one of those who had an oil supply that was not matched with my refinery capacity on the West Coast and I did not have a guaranteed market.

Alaska is a very difficult environment. We can't look at this on the basis of the pipeline being built. We all know it got started on a test basis on the 20th of June. That's hindsight.

When you talk about what kind of rate of return must you get, you've got to look at this oil pipeline as it looked to the companies at the time we had to make the decision to go ahead. And that started back in the '68-'69 time frame, after the discovery of oil, in the early days.

They have suffered tremendous delays. That was an element of the risk. The risk that they could not get the permit right away and it turned out they couldn't get the permit right away. And it took an act of Congress to get the permit.

Then it turned out that they couldn't get the permit

without agreeing to very, very substantial environmental constraints and costs. I'm not arguing whether they were necessary or unnecessary but they were a fact of life. They increased the risk.

There has been discussion about the potential for sabotage. Certainly every effort is going to be made to make sure that there isn't any. But if there is and if that line has to be shut down, the company is the one to bear the risk of that. It's not really being borne by the consumers. It's not being borne by the government. It's being borne very directly by the companies.

This is not your average pipeline. One thing that makes it more risky, perhaps, than others, is the fact that because of the environmental restrictions, it was necessary to build a large percentage of the line above ground. That makes it more vulnerable to those who would likely use it as a ploy, in a terrorist plot, or what-have-you.

So, there are some risks here. The thought that this is a nice, smoothly flowing line that's already started up and seems to be working well -- and we all hope that it will continue to do so --

Commissioner Stafford: You speak about the minimum risk up there, supr[illegible] were just minimum or low risk, and you quote your ex[illegible]s as saying 13, 13-¼ percent rate on valuation, I believe that was. Well, then, if you were building

that pipeline in the lower 48, then, where does that come into the -- is that a minimum risk there or what risk level is that?

Mr. Jordan: I think it depends a lot of where you are building it and what kind of regulatory constraints you may be subjected to. If you are building it across flat country -- Texas or Oklahoma -- that's one thing. If you are going to build it across the Continental Divide, through mountainous territory with all the difficulties there, certainly that'll be reflected in the cost of building. But I think it also bears to risk.

If you have to start out and invest money and you are uncertain of what the regulatory situation is going to be, that is certainly something that has to be considered.

And the whole uncertainty in the world oil market is a major, major cloud that hangs over all investments in the oil industry these days.

Commissioner Stafford: Is there a considerable difference in what you're asking for here and, oh, say, on an average, what you're asking -- what rate might be in the present lines you have?

Mr. Jordan: Well, I don't think there is. I think the reason that there isn't is that for many, many years the pipeline companies in this country have had their earnings effectively constrained by the consent decree.

The consent decree is, of course, not a limitation on earning, it's a limitation on the rebates in the sense that you can't pass back dividends to the parent company in excess of a seven percent return on valuation. And that seven percent return is calculated using interest as an expense.

The companies that are involved in this project, by and large, are subject to the consent decree because it applied to one of their predecessors in interest or affiliated companies or, as Amerada Hess said in its papers, they have voluntarily undertaken, in effect, to treat themselves as constrained by the consent decree.

Let me give you some figures that relate to this rate of return on valuation calculated by several of the carriers in their responses here, based on the assumption that interest would not be treated as an expense. That's been one of the big issues here, the interest treated as an expense.

Now, this really just involves adding back the interest expense to the net income figure that's otherwise shown, taking this total and dividing it by the valuation. That's the arithmetic involved and it's not complicated.

In the EXXON papers at page 45, using this methodology

they cite a rate of return of 12.25 percent; Amerada Hess, in its alternative calculation at page 9 of its response, gives a figure of 14.34 percent; Sohio at page 19 of its response, shows a figure of 12.9 percent.

So, what I'm saying to you is that taking this pipeline, even though it is a risky pipeline, and taking the calculations right off the financials of the companies involved, and putting the interest back in and measuring that against valuation, you come up with numbers that are right within the range for that minimum risk pipeline that Mr. Gary and Dr. Solomon talk about.

So, I don't want the Commission to have the idea that when I say the Alaska Pipeline is a risky element, if you disagree with that and you think there's been a cushion put in there for the risk, the cushion isn't there.

I think that the rate of return that would be justified, in view of the risk, would justify return considerably higher than those that have been calculated here. Because of the consent decree and other factors, that's not what's happened and the actual rates of return on valuation are right in the range that Mr. Gary and Dr. Solomon have specified in their verified statements in 308 as being proper and reasonable.

So, I th[illegible] are several important things that the Commission ou[illegible] to understand this morning about this rate of return issues. First of all, the rate of return figures

based on the phony debt equity ratios simply cannot stand scrutiny and all the experts, including apparently Dr. Ileo who was here for the State of Alaska, seemed to agree that these debt equity ratios are phony and just have to be totally ignored.

This whole matter of rate of return does not present the Commission with a crisis. It does not present it with some situation which demands extraordinary action because the rates of return that we're talking about are not extraordinary rates of return. They are rates of return right in the range where you would expect to find them.

And that means, as far as the carriers are concerned, that there is no justification for the Commission thinking that it is required, because of the numbers in this case, to depart from the wisdom which was set forth in the Williams Brothers' case to the effect that 308 is the proper forum for resolving these questions.

The Commission can move ahead and let these tariffs become effective, as filed, and yet be assured that in so doing it is not permitting an unreasonable or an unconscionable rate of return; that is simply not the case.

Commissioner Clapp: You don't believe that the standard that the Supreme Court set out in the Hope case is a fair one for determining a reasonable rate of return? The court said in Hope, I think, that revenue should include service on

debt and the return on equity sufficient to attract capital. If you would --

Mr. Jordan: Well, that's exactly what Mr. Gary and Dr. Solomon have done in their calculations. They've gone at it slightly different. One of them is an investment banker and he's very sensitive to the market and he knows how the institutional investors feel. The other one is a professor of finance and his is, perhaps, a little bit more theoretical.

What they have done, in both cases, they have looked at the yield rates for high-grade corporate bonds. In some cases, they've looked at the capital "A" double little "a" type bonds and, in other cases, they have looked at the overall corporate bond market; then, they have added a risk premium based on the difference between bonds, which are obviously less risky than equity.

Now, in doing this, both of them, as I recall, went back to the 8 percent-10 percent figures which were set by the Commission in 1940 and looked at the corporate bond rates then and the rate of return on valuations that were allowed at that time, and they both concluded that the spread between the prime corporate bond rate and the allowable rate of return on valuation in those 1940 cases was comparable to the spread which they are talking about with this 13 to 14 percent rate of return on valuation.

What's happened, of course, is the corporate bond market

has gone up. All capital costs more these days. You know, the days of the two percent government bond have not been with us for a long time. And the days of the two and three percent corporate bond have not been with us for a long time.

These are real world factors, these are the things that the companies have to face. But I think that the approach that they are contending for is exactly consistent with that statement and it is based on a market approach. In other words, in a regulated industry, you have to look to the competitive economy to see what would happen there. And the goal of regulation is to try to emulate what happens in the competitive world.

You can't have it precisely because, by definition, it's not the normal competitive world. Certainly, pipelines are a lot more competitive than public utilities are because they bear a risk of loss and they don't have certificates of public convenience and necessity. But these experts have done that; that's exactly their approach and that's the way they derive.

Commissioner Clapp: Isn't there some danger in relying heavily, though, on the cases of the '40s. The Commission has had very few pipeline cases before it, several in the '40s, and more recently the Williams Case.

But in the '40s, the debt equity structure was quite different and the formula at that time provided a reasonable rate of return.

The Protestants, of course, are arguing that the debt equity structure is so different now as to cause us to discard that.

Mr. Jordan: Well, you don't have -- that's an approach which they have used as a way of comparing their results. But if you look at both the Gary and Solomon papers, you will find that their approach is not pegged exclusively to that differential in 1940 between bonds and the rate of return allowed by the Commission. They've gone at it with other approaches, basically looking at the corporate bond rate and trying to assess the risk premium that should be allowed for an equity investment over and above the corporate bond rate.

And in the case of Mr. Gary in particular, he has relied very heavily on his experience in the investment banking business. He's out there on the street, so to speak, every day, trying to bring [illegible]s and those who need capital funds together. That's the acid test. It's not somebody's theory. That's where the real test comes and that's his business and

it is his considered judgment as expressed in a verified statement in 308, that you simply cannot finance a minimum-risk pipeline the way investors view the market, without allowing 13 to 14 percent rate of return on valuation.

Are there any other questions?

(No response.)

Commissioner O'Neal: Thank you.

This looks like a pretty good time to break so we will recess at this point until five minutes after eleven.

(Whereupon, a short recess was taken.)

Commissioner O'Neal: All right, we're ready to proceed with the next witness.

Mr. Lansdale: If Your Honor please, I am John Lansdale. I represent the Ohio Pipeline Company.

I would like initially, Ms. Christian, to try to give you an answer to the question that you asked about the other cases that use the parent company as the index of return.

The answer is yes, there are loads of such cases. We'll be glad to give you some if you give us a chance to look them up.

But one of the outstanding examples of it is -- most of the state commissions, in dealing with subsidiaries of AT&T, for example -- the way that system is financed, the local companies float their own bonds on their own risk, but the equity capital is supplied by AT&T.

Therefore, the commissions look to AT&T's cost of equity capital in calculating the rate of return. And they do this similarly -- this most often arises in the telephone cases because they're almost the only utilities that are regularly regulated and have much of a holding company system anymore.

But, the reasoning of it is quite simple. The question of rate of return is a question of fact. And to find the fact, you look to what the investor does. The securities markets, the cost of money in the securities market is unregulated; it's true competition.

And when the experts get on the stand and say, "What is

the cost of bond money? What is the cost of equity money?", they go and look at the stock market and the bond market and see what the behavior is.

Well, if that behavior is governed by the investor's perception of Standard Oil Company, for example, as distinguished from Sohio Pipeline, then the only fact you have is what are they willing to lend money for or to buy stock in, in order to rate Standard Oil Company, not Sohio Pipeline Company.

Therefore, that fact relates to Standard Oil Company, not Sohio Pipeline, except as it contributes to the risk, or the productiveness, as the case may be, of Sohio -- of Standard Oil Company.

Now, for example, in this particular case, you can perceive this in operation, because if you will look at the responses, you will find that the interest costs of these several companies vary quite widely. Sohio's is among the highest, 9.3 percent average interest cost of the bonds that it sold to finance, in part, its portion of the pipeline.

Some of the others -- I forget what they are. ARCO, for example, is around 7 percent.

This expresses the investor's appraisal of the differences in the risk. And one of the reasons Sohio's is the highest -- I don't know whether it's the highest or not, but if it isn't, it's very close to it -- is because Sohio is a relatively small

company in proportion to the others that have large interests in Prudhoe Bay.

And therefore, the Trans Alaska pipeline system, the whole Alaska venture, as to which so much money has been put out, is very much larger in proportion to its total capitalization for Standard Oil Company than it is for any of the rest of the companies. And you'll find, therefore, this expression of the investor appraisal of the differences in risk.

And so, the reason why you look to the parent companies is quite simple -- because there's no other way you can find out what the true cost is. And when you go to the parent companies, you're looking at the investor's perception of a conglomerate of some kind.

Sohio, for example, is in the plastics business, and in the chemical business and the coal business. They look at all of these things.

So, the answer is yes, there are loads of cases that look through to the parent company for cost of money or capitalization or whatnot.

And when you look at capitalization, this ratio, you're looking at an index of risk, in any event, because the degree to which the risk is concentrated in the equity side, and the smaller the equity, the higher the equity cost; and the larger the amount of bonds, the higher the bond cost; the lower the amount of bonds, the lower the bond cost and the lower the

equity cost.

So, we will get you some cases on that; just give us a few hours to look them up.

Commissioner Christian: Thank you, I appreciate it.

Mr. Lansdale: Now, if Your Honors please, I want to comment for a bit upon what I think is the basic issue before this Commission.

I am assuming for the purposes of my argument that Your Honors have power to suspend.

And, the question is, what is the issue before Your Honors on the power to suspend or on the exercise of that power?

Now, obviously, you have to look at what you think prima facie about these rates. Does it look like they may be too high? Are you disturbed or startled by the cries of outrage from the State of Alaska and the Bureau of Enforcement and the like?

And, obviously, if you are, obviously if you think there may be a question about it, you'll order an investigation. And, having made that determination, that an investigation is needed, you have one more decision to make until you suspend. Shall you suspend or shall you, like some godfather, make us an offer we can't refuse and say, well, no suspend if you go down a little bit.

Well, I was pleased to see, I was handed this morning a reply brief from the Department of Justice. I didn't have a chance really to read it but I scanned it. And I was pleased to see that the Department believes that the problem before you is the same as the federal judge has when he is asked for

a preliminary injunction, because that is what I propose to you in our response. This is what I believe to be the thing before you, the kind of thing a judge must decide on a preliminary injunction.

Now, in a preliminary injunction, one of the thing the judge decides is what is the probability of success after you have a trial? Because if he thinks that the case has no merit whatsoever, he's not going to listen to you anyhow.

But, having made that decision, he's got one more decision to make. That decision, the probability of success, is precisely like the decision you must make as to whether you are going to order an investigation.

Now, the second question is irreparable injury. Who's going to be hurt if he lets things go on as they are until he can decide the case?

The question before you is, who's going to be hurt and how much and comparatively how much if you let things go on as they are while you decide the case, because I assume that you are going to listen to the evidence, that you're going to give consideration. Now, whether you do it in Ex Parte 308 or whether you do it in a proceeding here and how fast you do it is a matter that I'm not going to get into. I assume, in view of the amounts of money involved here, in view of the publicity that it has, in view of the public interest in it, you're going to move as rapidly as you can consistent with

making the proper decisions. And whether you do that in 308 cr whether you do that in this case, I hope, is irrelevant to the validity of your answer after you get there.

But, right now, you have to decide who is there irreparable injury to that is going to be suffered by somebody if you don't suspend the rates? Is there irreparable injury going to be suffered by somebody if you do suspend the rate? And, how do you balance those equities,if you can bring yourself to think of equities, in the case of very large oil companies and in the case of, what appears to me to be,one of the wealthiest states in the United States.

Now, if Your Honors please, there is no consumer that's going to be adversely affected by whatever you do here, either adversely or the contrary.

There is no purchaser of oil in the lower 48, there is no refinery, there is no automobile owner at the gas pump, that is going to pay more or less for the oil or the products of the oil, whatever you do here today or the next two days, whenever it is you do it.

This is an interesting economics situation because you are dealing, for all practical purposes, with a closed circuit, so to speak.

To facilitate the State of Alaska's argument about double dipping, I would even call it a pond without an outlet, in which you have eight or nine people contesting for how you

divide up this enormous sum of money that is there, pending your decision, pending your decision.

Now, if Your Honors please, the wellhead price of the oil varies dollar for dollar with the tariff. There is no question about that whatsoever. And that is the only effect, the only direct effect, of a change in the tariff, and that is a variation in the wellhead price of the oil. I'm talking about consequential effect. Of course, it affects the income of the pipeline companies and the like.

Now, in considering what is the effect of some temporary order, and this is what we are talking about. We are talking about a temporary order. Shall you issue an injunction pendente lite?

In considering the effect of this thing, you must not assume that all of the interest here on one side or the other are uniform. Although we have attempted to cut down on what is, I am sure, an extremely tiring proceeding to you by getting together and trying to divide up our argument a little bit, you must not assume that the oil companies or the pipeline companies are a monolith in this situation because they are not. The differences are quite major.

For example, the Sohio Pipeline Company has 33 and a fraction percent of the pipeline. Its parent company owns more than 53 percent of the oil. It's got to ship over other people's pipeline.

Similarly, Union, which owns a small portion of the pipeline -- one and a half percent or something like that I think -- owns no oil whatsoever. BP Pipeline Company, quite indirectly, an affiliate of Sohio Pipeline Company, owns 15 or 16 percent of the pipeline and no oil.

There are one or two pipeline subsidiaries that are relatively in balance, but the point I am trying to make is that whatever you do, the relationship and the effect -- the financial effect thereof is quite uniformand quite complicated

Now, there is one thing that is not complicated about this and it is perfectly clear that if the tariff is up a dollar, the wellhead value of the oil goes down a dollar. And, therefore, the one-eighth of the oil which the State of Alaska owns is worth a dollar per barrel less. And the seven-eighths of the oil that the producers own, the State of Alaska's 12½ percent, almost exactly the same as their royalty interest, their 12½ percent severance tax is diminished if the wellhead price is diminished, with one exception, however. They have taken the precaution of putting a minimum in there of severance tax of 80¢ a barrel and, if you'll use your hand-held gadget, you'll figure that this figures out to about $6.53 a barrel, which is the minimum wellhead price that the severance tax will be paid on. And I think that in the areas that we are dealing with here, the severance tax can be read out of it. Alaska is not going to be hurt about severance tax.

And, even if they are hurt about severance tax, they have provisions in their statutes which enable them to assess the wellhead value and any errors in the determination of it will be remedied in due course.

And I might add that the State of Alaska's legislature has neither been backward nor slow about looking out for Alaska's interest in their -- financial interest in this oil.

Now, there are very large sums of money here, but the number of interests are very small. And the major interests

pressing for a lower tariff interim is the State of Alaska. Now, the State of Alaska -- I want to get out of the way at the beginning the fact that I don't think that even the State of Alaska, which has not been notable, at least, for its restraint in its brief, will claim that it is going to suffer any deprivation whatever Your Honors decide.

To give you an example of the numbers that we are dealing with and the effect on the State of Alaska, in 1975, which is the latest which I could discover figures for, in the tabulations published by the Department of Commerce, the State of Alaska's total tax revenue was $203 million. If Sohio Pipelines' tariff is approved, or if Sohio Pipeline's tariff is the one that is in force, the State of Alaska's severance tax, alone, in the next year, 1977, will be $306 million, approximately, 150 percent of its total tax take from all sources, in 1975.

Its royalty, remember, is 12½ percent, it's severance is 12½, its royalty will be somewhat more, $308,790,000, if my calculation is correct. And, in addition to this, we must not forget that they have taken the precaution of imposing a 2 percent ad valorum tax on the pipeline, and we have corporate income taxes as well.

So,I think that it is reasonably clear that whatever Your Honors decide, Alaska is not going to suffer.

Now, I haven't mentioned the Artic Slope Corporation. They claim that if this tariff goes into effect and it turns out that it's too high, their payments from Alaska's share -- the payment of Alaska's share of the several hundred million dollars that goes to them under the Native Claims Act will be delayed, thus they will lose something for the time value of money.

Well, of course, their payment comes out of Alaska's royalties and whatever happens to Alaska's royalties, I presume, will pass through to the natives. And I have no reason to suppose that the State of Alaska will be less fair than the oil companies are asked to be in that respect.

Now, the question is, will the State of Alaska suffer deprivation? Of course, under the Interstate Commerce Act we have ample provision for refund. And the Exxon Company, in its presentation, proposed a provision for refund in its rule which appears at page 67 of their brief.

I'm authorized by the other pipeline companies to state that they are perfectly willing to insert such a provision in their tariff providing for a refund at 8 percent interest.

Commissioner O'Neal: Now, does this meet the argument that I think has been raised in some of the pleadings that while refunds might be available, there may be a question as to whether the pipelines would actually apply for the refund since the owners benefit either way. You say you feel the tariffs are taking care of that problem? -- the tariff provisions

Mr. Lansdale: I have -- the tariffs certainly would take care of that problem because the pipeline companies would be obliged to make the refund and I want to invite Your Honor's attention to Section 1 of the Restatement of Restitution which provides that anyone who is unjustly enriched at the expense of the other must reimburse, or restore, that to the other.

And I wonder if there is anybody here that believes that if royalties are paid on the basis of a value which is fixed absolutely, dollar for dollar, by the tariff and the tariff is later retroactively reduced and refunds are made, or whether refunds are made or not, is there anybody here that really believes that the State of Alaska will not gets its money back, or they really believe there's any way for the oil companies to hang onto that dollar profit -- for example, to get a dollar refund from the pipeline -- and then keep this --

Commissioner O'Neal: Are you assuring us there is no way they can hang onto it?

Mr. Lansdale: I am asserting that if there was any way to hang onto it, I don't know. I have advised my client, Standard Oil Company, that they will be obliged to refund that I can -- before Your Honor today are the pipeline companies, not the oil companies, and I can't speak for the other oil companies, but I can speak for Standard Oil Company and I have so advised them to that effect.

And it's my understanding at the present moment, discussions have been initiated between the State of Alaska and the oil companies as to the determination of wellhead values under the terms of the lease. And I am advised, indirectly, by the counsel who represent the production interests of Exxon, that they construe the lease to indicate that a retroactive adjustment of wellhead value would have to be made if it is necessarily retroactively adjusted by Your Honor's action on the tariff.

Now, this goes to contract law. I think, if Your Honors please -- and those of us who have some experience in the antitrust laws would have no doubt that the State of Alaska could recover under the Section 7 of the Interstate Commerce Act which says that "anybody damaged".

And Your Honors may recall that there are two cases in the Supreme Court of the United States which deal with the right of -- the damage right is called "pass-through". Under the antitrust law, the language of Section 4 of the Clayton Act is almost exactly like Section 7 of the Interstate Commerce Act.

And in antitrust law, the courts have held that the customer of he who pays too high a price may not recover; not because he's not damaged or may not be damaged, but because of the difficulties of proof, the impossible or almost impossible management of the litigation of the enormous numbers of

people involved in the consumer end of it. However, in both of those cases which made this decision, Hanover Shoe on the one side, on the defendant's side, and the Illinois Brick, just a few weeks ago, on the plaintiff's side, in both of those cases, the court pointed out that if you had a cost-plus situation, that would be different.

The guy who had the cost-plus arrangement could recover because he is directly damaged. And if you can think of anything more cost-plus than a situation in which the tariff is reflected, dollar for dollar, in the wellhead price of oil, I don't think there is much difference.

Now, the point I wish to make, if Your Honors please, is, what you are asked to do here by the Protestants, is to impose a lower rate, to say to the oil companies, "You can stop the pipeline if you want. But if you don't want to, you can file a lower rate."

Now, I don't care what circumlocution you use. The fact of the matter is that you will be dictating a rate to these companies. And what --

Commissioner Hardin: Mr. Lansdale, in the beginning of your statement you said you were assuming that we have the power to suspend?

Mr. Lansdale: Yes, sir.

Commissioner Hardin: If I understand your position correctly, and let me just summarize it for a minute, you are assuming we have the power to suspend on the basis of what is considered in the courts in the issuance of the TRO, which is that there appears to be some unlawfulness about it. That would be the basis for the power to suspend.

Mr. Lansdale: Yes.

Commissioner Hardin: Are you saying then that even though we have that power to suspend that we do not have the power to prescribe a rate?

Mr. Lansdale: I certainly do. I certainly do. Because if you prescribe a rate, you are not suspending, you are prescribing a rate. In the statute that Mr. Kilcarr, I thought

so eloquently presented it, the statute says you have to have a hearing before you prescribe a rate. You have to give the oil companies -- much as the State of Alaska would like not to -- you have to give the oil companies a chance to be heard on the facts of this thing. You have to have some sort of an evidential basis. Your own rules, as Your Honor please, provide that a hearing of this kind shall be informal, that there shall be no transcription, that there shall be no evidence, that nobody shall be put under oath. This is not designed to be an evidential hearing in which you decide what the rate shall be.

And if Your Honors please, I say to you, that you've got to decide, not what the rate should be , but what are the equities of the situation.

If you were a United States District Judge, deciding whether to issue a TRO or a preliminary injunction, you would be required not alone to decide whether it looks like something might be wrong but who's going to be hurt?

And I'm trying to say to Your Honors that if you succumb to the temptation to impose -- and I use that term advisedly -- to impose a different rate on these companies, you will have decided now and today or tomorrow or day after tomorrow or whenever you decide it, you have decided that whatever amount by which you reduce those things, is not going to go to the pipeline company. It's going to go to the State of Alaska and

it's going to stay there.

And there is no way, there is no way, that the pipeline companies can be made whole.

Now, if Your Honor please, we've talked about risk here a little bit. We talked about risk here a little bit and I've noticed a lot of language in the Department of Justice saying about the necessity to preserve inducements to explore in the State of Alaska.

Think for a minute, if Your Honors please, about the effect, the chilling effect, if you please, on the next guy that's asked to invest money to bring oil -- whether we have what the Department wants divestitured so we have pipelines standing alone or whether we have oil companies -- think what happens to the next fellow that is asked to invest in a pipeline in very difficult circumstances, to spend however many years -- it's taken several years and billions of dollars. The investment up there, if Your Honor please, is over $13 billion at the present time and not one penny has been taken out by the oil companies. The State of Alaska got $500 million from advanced severance taxes and $950 million from selling leases. But the $13 billion investment that's already been made has not made a penny of it.

Now think for a minute, Your Honors are asked to say now, today, the State of Alaska shall permanently get an extra dollar, an extra two dollars, depending on whose brief you

read,or an extra three dollars for every barrel of oil, which they will get to keep and there's no way, there's no way, for the pipeline companies to get that back.If Your Honors, after listening to the evidence, as we believe you will, decide that these tariffs are approximately right -- there's no way for us to get that back.

And if Your Honors please, if you let the situation stay like it is, if you let it stay like it is, the economic interest will be and can be readjusted so that nobody is really hurt.

And the only reason I went into this business of how much money Alaska is going to take out -- and, believe me, they're going to be rolling in it -- there's no way -- the reason I went into that was because there is no possibility of anybody getting hurt because they don't get their money for a while.

And I submit to Your Honors that it is not only illegal, it would be immoral for Your Honors to sit here and to say, take two dollars, or take one dollar, out of the pockets of the pipeline companies and give it to the State of Alaska that is already going to get two or three times their recent tax take, temporarily, because of these unsubstantiated -- in the briefs and in the efforts to get Your Honors to change, instantly, your method of regulation. There is no moral or lawful basis for you to do this thing to these companies and think what the next fellow who's asked to invest money to get

oil out of the Arctic or out of some other difficult place is going to think about, if you do so, when they're asked to invest $13 billion before they get a dime out of it, to be met at the very moment of fruition with a demand to give a dollar or two dollars to the State of Alaska on the supposition that these unsubstantiated claims might just be true.

I submit to Your Honors that you should not do this.

Commissioner Clapp: Mr. Lansdale, you don't think the power to suspend implies the lesser power to suspend without predudice, is that correct?

Mr. Lansdale: Oh, I think it implies the lesser power to suspend without prejudice in a case in which the one who is the recipient of this order has a real choice.

You may recall that in this Chesapeake and Ohio case, just decided last year by the Supreme Court, where you did put a condition of investment of the use of the money, and by a divided court, the Supreme Court approved this thing.

And they approved it because this was in furtherance of the status quo, and that is to say in the public interest, because if the companies didn't need this money for rehabilitation and refurbishment, then by definition under your decision, they didn't need the money.

And so, to protect the abuse of the public interest, you had the power to do this, and so the Court held. But I wish to point out, in that case, that the Court also pointed out that Chesapeake and Ohio didn't have to do this. All they had to do was wait seven months and put it in. So that, they had a real choice. We have no choice in this case.

If Your Honors please, if this pipeline is stopped, you're going to have an 800 mile cannon. And what would the State of Alaska do about this?

Now, why should the economic burden of succumbing to this

difficult choice be on the oil companies? The State of Alaska has a stake of 12½ percent royalty and 12½ percent severence tax in this. They have the biggest single, I think, economic stake in this thing, except Standard Oil Company.

And I submit to Your Honors that we, having made the investment -- now one way Alaskans can protect themselves, by the way, is to buy a piece of this pipeline. And I'll bet you that if they want to put some of that cash on the barrelhead, I can arrange a sale.

(Laughter.)

Commissioner O'Neal: For planning purposes, let me point out that the pipeline's time will run out at 11:57. I think we would like to have one more witness after that before lunch.

Go ahead and proceed.

Mr. Schwartz: Union Alaska will be very brief, Mr. Chairman. May it please the Commission, my name is David Schwartz. I appear today on behalf of Union Alaska Pipeline Company, one of the owning TAPS carriers who have been erroneously characterized by all of the Protestants.

Union Alaska and its parent Union Oil Company of California do not own any crude oil production capacity on the North Slope. And direct and indirect allegations to the contrary are simply untrue.

In addition, Mobile and Amerada Hess, also, have pipeline capacity in excess of their production.

The fact of our non-ownership of North Slope crude production gives rise to two very important facts which we urge the Commission to take into account.

First our entire investment of $144.2 million in TAPS must be supported by revenue from unaffiliated shippers on Union Alaska's pipeline capacity. And our rate of $6.09 has been kept to the lowest possible minimum to attract such traffic. To repeat, we have no North Slope crude production operations. Thus, the allegation that producer-owners can somehow recoup revenue has no arguable applicability to Union Alaska.

Second, I would like to turn to this pejorative double dipping argument of the state as to interest expense. In our view, if this is adopted, it would guarantee that no

corporation would ever invest in a pipeline again.

Let me give you an example of how this would apply to Union Alaska to illustrate the ultimate absurdity of the position. If today Union Alaska were to seek to borrow 100 percent of the capital it invested, that's $144.2 million, to finance the project at a 7 percent interest rate, and were to invest no equity capital, the effect of the state's approach would be to allow us no net income.

Now, if one were to use a more realistic figure for long-term financing of 8 percent or higher, Union Alaska would end up in a loss position.

I respectfully suggest to this Commission the state's approach is not the type of economic incentive to encourage private capital's assistance in dealing with the energy crisis or to improve this nation's transportation system.

Now, this is particularly true in the risky area of oil exploration. Union Oil has spent $100 million in unsuccessful North Slope exploration -- a $100 million. If that doesn't constitute risk, I don't know what does.

Now, this Commission is fully aware of the role that incentives for private capital can play in transportation. You recently exercised forthright leadership in this regard, in Ex Parte 252, Sub-No. 2, in guaranteeing incentives for per diem payments on gondola cars and, in Ex Parte 327, dealing with capital incentives in railroad ratemaking.

Union Oil urges that the Commission recognize these hard facts of economic life. We urge that you allow these lawfully constructed rates at issue to become effective with publication of a contingent refund provision, including interest.

Thank you.

Mr. Vickrey: Mr. Chairman, I am the last lawyer for the pipeline companies. I have about ten minutes. Would you like to hear it now or after lunch.

Commissioner O'Neal: No, we would like to hear it now, yes, and we will hear from one of the other Protestants witnesses before lunch, that's the point I was going to make earlier.

Mr. Vickrey: Mr. Chairman, Honorable Commission, this is a very unusual case. The only Protestants --

Commissioner O'Neal: Could we have your name for the record, please?

Mr. Vickrey: I'm sorry, sir. I'm Jack Vickrey; I represent BP Pipelines, Inc.

None of the Protestants are shippers. The only Protestants who claim an economic interest are the State of Alaska and the native group who claim that high tariffs will discourage exploration in Alaska.

I believe it's been adequately shown that the tariff rates will have no effect on the delivered price of oil which will be set by competition from foreign oil. Therefore, you don't have an interest in the public as you usually do in a suspension case.

Interestingly enough, the Protestants don't try to suspend these rates on the ground that they are out of line with the industry standards or the ICC regulations, but they

say that the ICC standards that they've been applying for all these 70 years are all wrong. And this is, in effect, an attack upon the Commission's practices as much as it is these tariffs.

The application of the public utility FPC tie-up rate of return on equity concepts is not only inapplicable here but it reflects a total lack of understanding on the part of the Protestants of the true nature of the oil pipeline industry.

I read in the Oil and Gas Journal the other day that the Federal Power Commission intends to transfer 1455 people to the new Department of Energy. I noticed the ICC will transfer only 17 people. I think this reflects somewhat the relative health of the two industries, the oil and gas industries.

The highest rate suggested by any of these Complainants will not even permit carriers to earn enough to pay their debts during 1977. And if there is a slight deviation in the estimated throughput, this would include the period of 1977 through 1978.

Under their return on equity theories, a pipeline like the TeSoro in Alaska, which has 100 percent debt, would be entitled to a zero rate of return because they have no equity.

Before this Commission discards its present regulatory procedures, I think it should first review the condition of the oil pipeline industry today. There are now 220,000 miles of oil pipelines in this country, all built by private capital

without government subsidy.

The Transportation Association of America reported recently that oil pipelines transport 23 percent of the intercity freight tonnage at a cost of only 1.3 percent of the nation's freight dollar.

During the period from 1947 through 1974, the average revenues per ton-mile for all pipelines increased only 8 percent, while the consumer price index rose 121 percent. It's highly unlikely that the oil pipeline rates would remain stable during this period of inflation if they had been regulated on a FPC cost-of-service basis.

Anyone who has paid a gas bill lately knows this. The Independent Petroleum Association of America, who represents over 4,000 independant oil men, told Congress recently that it knew no producers who had any difficulty in moving their crude.

The oil pipeline industry has been able to achieve this because both Congress and this Commission have recognized that oil pipelines are a unique form of transportation and should not be regulated under utility concepts.

Oil pipelines are wholly unlike public utilities. They do not have exclusive franchises, must compete with other pipelines and other forms of transportation such as truck, tankers, barges.

Oil pipelines are high-risk, capital intensive ventures that are built to serve specific needs. They operate in only one direction, and they cannot be moved to new locations very easily.

For these reasons, experience has shown that no one is interested in investing in an oil pipeline except the oil interests they serve. Proof of this, I believe, Mr. Chairman, is shown in some of the documents filed by the AOPL in Ex Parte 308, that 95 percent of all the crude oil pipelines in the United States move through shipper owned lines.

The other 5 percent who are independently owned -- most of those, like Buckeye and Williams Brothers, originated by oil company ownership; they were built that way.

So this is proof positive, I believe, that there is no ready market for oil pipelines in the general investment field.

There have been several attempts through the years. I can remember the American pipeline and the U. S. pipeline, where a group of promoters tried to promote an oil pipeline. All of them failed because of lack of financing.

All of the new pipelines that have been built within the last decade have obtained their capital by throughput

agreements or by direct guarantees from their owners. Without these guarantees, capital simply could not be obtained. And because of these financing practices and the nature of the business itself, debt equity ratios are meaningless in all pipeline regulations.

Capital obtained by throughput committments or guarantees are really the equivalent of equity, according to Mr. Gary, who has been quoted before.

Any attempt to measure the capital structure of BP pipelines, whom I represent, whose entire capital was raised from its parent by either capital contributions or guaranteed debt, is a distortion of regulatory practices.

Capital to finance the Trans-Alaska venture could not possibly have been raised by independent investors if you had utilized a 45-55 debt equity ratio such as is common in the gas industry. The owner companies had no choice but to guarantee the debts to finance this system.

Now, to penalize these owners who put their credit on the line, by applying return on equity concepts for the first time by this Commission in a pipeline case, in a suspension proceeding without a full hearing, would be unconscionable.

I agree with the counsel who preceded me, that this Commission lacks the power to extend initial rates for a carrier that has no other revenue. To suspend and dictate a lower rate in a suspension proceeding would constitute

ratemaking.

To suggest that this Commission would engage in a sham proceeding to coerce a lower rate slanders the integrity of this Commission.

Commissioner O'Neal: Thank you.

Mr. Shibley: Mr. Chairman?

Commissioner O'Neal: Yes?

Mr. Shibley: I am Raymond Shibley, and I represent Phillips Alaska Pipeline Company. And I wonder if I might have 60 seconds just to state the position of Phillips.

Commissioner O'Neal: I think you might have 60 seconds. Fine.

Mr. Shibley: May it please the Commission --

Commissioner O'Neal: Can we have your name again for the record?

Mr. Shibley: Shibley, S-H-I-B-L-E-Y.

The Reporter: First name?

Mr. Shibley: Raymond. I'm representing Phillips Alaska Pipeline Company. I just want to underline a request that we have made in our filing for, in effect, joining Exxon in requesting authorization from the Commission to permit amendment of the tariff proposal for a provision for repayment of any amount that this Commission finds to be in excess of just and reasonable rates.

We have made the request without provision for interest,

but we would be agreeable to the Exxon proposal for 8 percent interest.

We strongly urge that this procedure be adopted by the Commission in lieu of other possible sanctions or proposals, simply because it is more practical, and because it is fair, and because no one will be hurt.

In this manner, the status quo will be preserved by the Commission, while the investigation and hearing is proceeding.

For purposes of this presentation, we are assuming the Commission does have the right to suspend, but not the right to prescribe interim rates. And in this manner, all parties can be protected, including the State of Alaska.

Thank you.

Commissioner Stafford: Did you say 8 percent? That you agree to 8 percent?

Mr. Shibley: Yes, Your Honor.

Commissioner O'Neal: Thank you.

Now, for the Protestants.

Mr. Cleary: If it please the Commission, my name is John Cleary, and I represent the State of Alaska.

I have asked that there be distributed to the Commission a series of oral argument exhibits. I recognize that Mr. Flynn posed an objection to them but I think they are acceptable and I ask that they be utilized.

I also have a larger graph which is here in front of the stand. I ask my associate, Mr. Toomey, to set that up so that maybe the Commission can see that also. It is a reproduction of the first page, which is the Protestant TAPS Rates Graph, separating the individual tariffs in cents per barrel by their different elements.

Commissioner O'Neal: Mr. Cleary, how much time are you reserving for --

Mr. Cleary: I would like to reserve fifteen minutes but when the green light goes on, if I have anything else, I may use a little bit of that time. I take it the green light will go on at five --

Commissioner O'Neal: When you have five minutes left.

Mr. Cleary: One of the reactions I have here coming this

morning and I had it before is, there is a strange feeling of deja vu. Yet I have difficulty following the carrier contentions. At one point they are saying you must penetrate to the parent company and look at the parent company for the cost of capital or the capital structure. And at other times they are talking about, don't change any rules, and they want to talk about using a valuation base because you cannot change any rules and the rules that you have followed at this Commission -- and I must say, as you well know, I have challenged some of those, as was pointed out this morning.

We have challenged the valuation rate base in proceedings at this Commission. But the rule as it now stands is that a valuation rate base is what the Commission uses.

But the TAPS carriers display an arrogant insensitivity to the mandates of the law. They distain the Commission's power to prevent unlawful carrier acts, at least when the unlawfulness is manifest in initial pipeline rates.

I submit that these rates are clearly, manifestly, unlawful, under the Commission's present standards.

The TAPS carriers' contemptuous assertion that the ICC does not have authority to suspend definitely brings back a feeling of deja vu, which was emphasized this morning when counsel used t[illegible] "let's make this perfectly clear".

We are to [illegible] the oil pipelines are above and beyond the law that would prevent others from acting unlawfully. In

asserting that the ICC cannot suspend, the implicit assumption is and must be, that the predicate to that position is, regardless of how unlawful the initial rates might be -- that point adequately made and very perceptively made by Commissioner Hardin -- that suspension power exists to enable the Commission to prevent unlawfulness. That power is not limited only to situations where an existing rate is being changed.

The Section 15-7, powers of the Act, clearly permits and indeed require the Commission to suspend.

The pipelines are coming eyeball-to-eyeball with the Commission. They are telling the Commission "you have no power". I believe that is one of the quotes. And I believe the implicit threat in everything they say is, of course, that they will be in court.

Whatever you do, if you put an order out, they're going to take it court. And I suggest, perhaps, the courts are the ones to decide the matter, whether or not to resist that power.

Commissioner Hardin: Mr. Cleary, could I ask your opinion on a couple of things here just for a few minutes?

You state that you do believe we have the power to suspend initial rates. Now going back for just a moment, Section 216(g) contains a grandfather clause. That grandfather clause reads this way, that this paragraph shall not apply to any initial schedule or schedules filed on or before

July 31, 1938 by any such carrier in bona fide operation when this section takes effect.

Now, it seemed to me in reading that, that there would be no necessity for a grandfather clause to say that this paragraph shall not apply to an initial schedule filed on or before July 31 by any carrier in bona fide operation when the section takes effect, if we did not have the power to suspend initial rates.

Now, if we look at it in that light and we look at Part 3 and Part 4, we find the same grandfather clause is in there.

Now, it seems to me that the intent was and that the feeling was, up to that point, that this Commission does have the power to suspend initial rates. Now, this says "carriers in operation prior to" that date. If you have a new carrier, then we would still, it would seem to me, have the power to suspend those initial rates.

Now, would you give me your comments and opinion on it?

Mr. Cleary: I could not say it more eloquently. I would just agree that the Commission does have the power and I believe the Commission has exercised the power for many years which perhaps is strange that we do have pipelines coming here. Perhaps, for many of them, they think it is the first time they have been before this Commission. I don't think it is case, because we have at least five of them who have been regulated carriers for a long time. They know the rules.

The other ones are coming in and their companies are related to oil companies. They know the rules. I just find it a little bit farfetched that they claim that the Commission really doesn't have the power. But I say you do have the power and, at least, exercise it.

They are going to go court. Let the courts tell you what your powers are. And I suggest that, if there should be such an erroneous interpretation of the law, contrary to Commissioner Hardin's view and contrary to mine, that there is a lack of suspension, we better find out about it and make sure that unlawfulness can be stopped. And I always thought it could be stopped by this Commission.

Now, they keep saying we are asking that the rates be prescribed or set. We are not. We give an argumentation that shows that the rates are unlawful in certain degrees.

Now, in fact, had the carriers decided to read the law a little bit more carefully -- and I haven't heard much of

the cases of this Commission cited today. They have gone off into theories of irreparable injury,and court arguments and that sort of thing. Irreparable injury is not a criteria within the question of suspension except under the recently enacted questions of the 4-R Act in power over the railroads. But it took a specific Congressional amendment to say that we now, in connection with railroad suspensions, have to have an affidavit and an affirmative complaint alleging irreparable injury. It took Congress a year ago to do this. Obviously, it has never been a part of this argument before.

I do not, in any way, diminish the fact that there is irreparable injury. I have reached that point.

Prevention of unlawfulness is the subject and purpose of the Commission's suspension powers under Section 15(7). Where there is a prima facie unlawfulness, the tariff should and must be suspended.

Alaska submits that there will be irreparable injury, one to the public interest, generally, whenever there is something unlawful. Two -- and, specifically, to the public interest, generally, by retarding the development of known petroleum reserves. I am reluctant to quote again and I don't think I will, but I will paraphrase Mr. Patton. I quoted him in the protest. It was a speech he gave in Los Angeles.

He was talking about additional cost caused by the environment, and he said someone is going to have to pay for

these, and that everybody knows. And that's what we are talking about. Everyone is going to have to pay for the cost of this pipeline.

But he emphasized another fact that there are additional problems because the higher the cost -- and he was talking about these additional environmental costs. The same thing applies to the excess earnings that might be flowing from them. To the extent there was additional cost, not necessary, this retards the development of no natural resources. And that's what we are talking about.

This does have an impact. And I submit to you that the whole story hasn't been told yet as to the effect of the pricing of Alaska North Slope oil on the domestic pricing in the lower 48 under the Congressionally mandated maximum limitation prices.

So, there is a public interest involved. But this Commission is on the transportation standard. It has always recognized that. You are not trying to allocate markets of petroleum or anything else. You are paying attention to the transportation standard and that's what the statute calls for.

So, the public interest is definitely being adversely effected by discouraging applications and investigations for new oil by other than the club that owns them -- owns the pipeline.

Union e[illegible] it is just a pipeline. Well, I submit that there must be some interest in there that they hope to

get in attacting, at least, some people who will be maybe other than those who do own the pipeline, who will be very closely tied to their parent company.

There will be additional irreparable injury to the petroleum cost borne by consumers, in particular, because the high TAP's tariffs will depress the wellhead price of Alaska North Slope oil, thereby resulting in or leading to an increase in the price of other domestic oil under the average ceiling prices.

Suspension of the rates does not mean the consignment or the suspension of service. That has been threatened. Sohio, at page 3, they say that there will be a suspension of service. Here we come eyeball to eyeball. Apparent tenacious pipeline refusal to publish lawful rates, or to provide lawful service under lawful rates cannot empower those carriers to refuse their common carrier duties.

In my 20 years before this Commission, I have never heard such a high-handed approach as evidenced by these so-called common carriers. They have threatened no service on the transportation of a vital national resource unless they get their tariff.

They try to intimidate not only the Protestants but the Commission, itself.

Commissioner Hardin: If their rate is suspended, what rate would apply?

Mr. Cleary: They would go back, under the standards, and publish a lawful rate. And I submit to you, they will follow and find the lawful rate by reading the Commission's decision. The Commission's decisions and all the Commission need say at this point is, "We suspend these rates", and give the reasons that are usually articulated, give a little bit more.

Now, let me turn to some phraseology and I'm going to lead right into my argument.

Commissioner Christian: Mr. Cleary -- before that, I'm afraid you didn't hear my question. My question was, what happens if they don't? Suppose the Commission issues a suspension order without prejudice to a lower right?

Mr. Cleary: They'd have exercised --

Commissioner Christian: The oil companies know what rates they can file without suspension, but they don't try.

Mr. Cleary: And that's apparently what they've threatened to do because they say, "We will file", or maybe they say, "We're being coerced".

Commissioner Christian: Then what happens?

Mr. Cleary: Well, it's their total free judgment as to whether or not their economic self-interest is to file something that would be lawful in keeping with the Commission's standards and, therefore, permitted to become in effect, or whether they stand there eyeball-to-eyeball and litigate

through the courts or whatever else they're going to do, and say, "We will stop the oil from flowing", and in the wonderful phrase of Mr. Lansdale, "that we have a large cannon in Alaska", I think that that's not a likelihood. And I don't think it means coercion.

When the Commission says, "All we are saying is this rate is unlawful that you follow and filed on", that is lawful. And we find that it is unlawful to the extent the rates would produce an annual return in excess of 8 percent upon the value of their property used in the transportation of crude oil, of crude petroleum oil, by pipeline.

Now, that is a prevailing quote --

Commissioner Christian: Before you get to another point, Mr. Cleary, I thought you were leading up to another argument so, since you weren't, let me lead you into it.

When you talked about common carrier duty, I thought you were leading up to some sort of contention that if the pipelines failed to refile at a lower level, that the Commission would have some sort of authority to compel them to honor their common carrier duty. You weren't making that argument?

Mr. Cleary: I haven't pursued that. I think there would be a right in the Commission but, perhaps, more so in the federal gove[illegible] failure to meet obligations under the lease. [illegible] obligated to be common carriers. Perhaps that is one of those contract law questions under the

right-of-way lease; that they are ready to go, that they will filled the line sometime by the mid-to-late July. They will be ready to start performing transportation services at that time and then they say "We don't have a tariff because our tariff has been suspended". The next, of course, implicit beyond that, is "And we have refused to follow the guidelines of the Commission and file one that would be lawful".

Commissioner Stafford: What would be a tariff, then, that they could file?

Mr. Cleary: A tariff that would produce an annual return no more than 8 percent upon the value of their property used in the transportation of crude petroleum oil by pipeline.

Commissioner Stafford: Are you agreeing with what they say the value of the property is?

Mr. Cleary: For the purpose of this point and at this point the valuation that is being used is a waiving of the original cost and cost of reproduction made at the first day, as if it is 100 percent brand new.

There is a difference, and it's an unfortunate difference, between such a value and the cost of construction. I want to make it clear, and I will make it perfectly clear, that the State of Alaska has not argued in this protest that you should try, at this point, eliminating any of the expenditures which might be characterized as unreasonable, or in excess of what this statute mandates, the expenditures under, quote, "honest,

economical and efficient management". That's the standard that will be applied in the hearing.

We're not asking that you lop off any particular amount at this point. All of our argumentation, all of the assumptions have been that every penny that these people claim to have laid out, including the interest during construction, including a failure to recognize the tax savings that oil parent companies have had for at least three years, which they report to the SEC -- and I've heard not one word of it today here -- including all those monies that they have spent and the tax benefits of them which have current value, we are not asking that one penny of that be eliminated.

We do object to the valuation, because under the Commission's formula, you take the original cost, which the formula says is $9 billion, 280 million, as I understand the figures used by the Commission's Bureau of Enforcement -- which I believe were merely provided them by the Section of Valuation or the Bureau of Accounts -- the number would be $9 billion, 280 million for the original cost. That includes everything.

What does the Commission's formula say this thing is going to be used for a rate base as? $9 billion, 747 million -- right off the start, the Commission's formula throws in an extra 6 percent. That's what I've been arguing about with this Commission for 10 years.

I don't think it's right. But for the purpose of this case, let's stick with the standard.

Last December in the Williams case, this Commission said, "Consistency and fairness requires us to adhere." They would not deviate. The entire Commission would not deviate from its standard. And that was the standard used.

What was that standard? The oil companies know it. They know what the standard is. They never once mentioned the gathering rates case. They never once mentioned the Readers Pipeline Rates and Gathering Charge case, the Petroleum Rail Shippers Case.

They mentioned Williams, because the Commission did reaffirm that they would not deviate in the context of a

particular case. We will hold that for Ex Parte 308.

But let's talk about that standard, and the language I use. And I say the Commission can suspend the usual, it further appearing that follows right before it -- behind the recitation of the tariffs. The next paragraph in the suspension order, it further appearing, cause to find it would be unjust and unreasonable.

Now, you can go on. I don't think you have to. But apparently, they need some education as to what the law is. And so, if you do go on, we could say "unlawful to the extent the rates would produce an annual return in excess of 8 percent upon the value of their property."

If you look at the chart that we worked out, you go to about the fourth page. I have a schedule in there. But it would be the total TAPS revenue, providing 8 percent return on valuation. Allow all the operating expenses. Account for 93 cents a barrel, other than depreciation.

Depreciation is, of course, an operating expense under the Commission's accounting rules.

Allowing for that, on a 25 year basis -- and we disagree with the 25 years, but even then, that's 84 cents -- total operating expenses are only a dollar, 77.9 cents -- $1.78 to operate the line. That's an operating ratio, an operating ratio in the 20's.

That ought to immediately get people of this Commission

thinking, "An operating ratio in the 20's, that's pretty good". Admittedly, there's a large capital investment, so you look beyond.

Well, the Commission has said 8 percent return on valuation; that would be $1.78. And if you do include taxes -- and I disagree with that. And I argued so in the Williams case. The Commission never, up until the Williams case, had imputed 48 percent tax rates. They did it in that case, in my opinion, without much rational explanation.

The national area rate case was decided from the Federal Power Commission just a week ago, a little over a week ago, by the United States Court of Appeals here in the District of Columbia. They upheld the Power Commission deviating from its practice of not imputing taxes. But they did so because there had been a very well articulated rationale and reasoning.

There has been none, so far, from this Commission as to why, at least in the case of pipelines, we're going to flow in a gratuitous allowance for federal income taxes.

But we calculate it in. We've added it in to this calculation. It's all right; it's in there. We think you better look at what it really means in terms of the economics of it.

We think you should look at such things as the Exxon pipeline floatations of-- or, support of bonds underwritten from the City of Valdez, little circular. They have to tell the Securities and Exchange Commission about deferred taxes.

We used some of those numbers, in our calculations for Dr. Ileo, when he made specific calculations.

About 5 percent of the capital of Exxon pipeline, as of last December, was in the form of deferred taxes. That means that it's a tax free loan, cost free loan, interest free loan, a deferral. It has a current value, it has time value.

The oil company parents, through the use of consolidated tax returns, have been using these since 1969, I believe, some of them -- certainly since 1974 -- which gets me off on a little tangent.

The pipelines -- I guess, today, I guess they're recognized and they are subject to jurisdiction. They have been telling this Commission for a long time, and not subject to your jurisdiction, or some in question at least, including such as Sohio and ARCO.

If you look in your own annual reports to the Congress, if you look in your own transport statistics, you've been reporting them for years. And curiously enough, the numbers that you have in those transport statistics have recorded the investment in Alaska as part of a measure of the return.

I don't think it makes much sense. I would call that -- maybe the pipelines terms that they have used towards some of the calculations -- "phoney capital structure". Well, it's a phoney investment. You put money in an investment before there's any revenue being generated -- it's a misleading number. But there it was.

What it shows, though, is that the pipelines have been subject to I.C.C. jurisdiction so we take this 8 percent return which is the standard. The Commission clearly stated it some time ago, back in 1940, in the reduced pipeline rates and gather and charge case, that return of 8 percent will give $1.78 a barrel.

You add that, the total revenue need, after allowing taxes as computed to be 21.7 cents, a rate of $3.87; that would be on the average. The average rate that the State of Alaska had computed admittedly using what we think is appropriate, analyzing the original cost. Don't start throwing in this gratuitous 6 percent because we are against that value base.

It leads to inflation; it has led to inflation and what it leads to is high rates that would permit someone, if there would be an idea of selling a pipeline under the law or because someone decides to profit from the sale, of capitalizing parent income streams. Exactly what happened in the Williams case.

You had a pipeline that had an original cost of $184 million. It had already been half depreciated and only had a net book value of $91 million -- or excuse me -- $83 million. $91 million worth of depreciation had already been recovered.

It was sold. Why? Well, I guess someone thought they would invest in pipelines. The person who has invested in

that pipeline has continuously reported to this Commission and said, "We are an independent line. There are no ties. We don't have any throughput agreements. We don't have any guarantees".

They paid $283 million for it, $283 million. That's what happens when you use a valuation base. That's why we against it. But the first year, valuation and original cost are basically the same. And as the other side has said, let's not discuss that here. That's for 308.

I do wonder -- the Administrative Law Judge has said that Ex Parte 308 was not a judicatory proceeding. There will be no discovery, which was affirmed by an order of Commissioner Hardin.

These people talk about on the hearing records. I don't know how they are going to solve those problems and get what they think is a proper day in court. I do say that all of the witnesses they've quoted, so far, were witnesses from 308 who have not undergone cross-examination.

The pipelines didn't submit anything in the initial round. There has been no opportunity to respond to their documentation and whatever the witnesses have said, and I would like to respond one additional point at this -- use a little bit of my time to the reference to Dr. Ileo who is here in the courtroom

I've asked that the transcript of the Makisky hearing

be brought to my table and it's sitting over here. And I welcome anyone from the Commission to read them in their entirety.

In the response to the protest, the word "disingenuous" was used, attributed to some of the Protestants. I suggest that quoting Dr. Ileo so far out of context that it's just incredible. If they read that entire transcript, it would make it quite clear that What he was talking about was a company where there was no separate identity, there was no separate debt, which is not the case with these companies who are a floating debt to the public and offering it through SEC filings; they are separate corporate entities.

It is interesting, of course, that they want to disavow the criteria of the Commission other than the valuation. The Commission's standard and criteria was 8 percent on valuation. It was a firm and reduced pipeline rates and gathering charges in 1940; reaffirmed in Petroleum Rail Shippers in '41; reaffirmed, again, in the Minnalusa Case in 1944; reaffirmed, again, in the reduced pipelines' further hearings in 1948. In Williams, I know that language rather well because I love the consistent and fair standard and I am calling it to mind, because it is very important, the consistent and fair standard of the Commission applied in that case -- let me get my quotation here.

In passing, I note here in my file, INS-9089, a subsequent decision by Judge Dowell, where he reaffirms. He said he couldn't deviate from it. I refer also to the K-9 Case, where Judge Nacy pointed out that the 7 percent -- Department of Justice consent decree is no ICC standard.

I would say that, in passing, whoever calculated numbers upstairs fed them through the legislative office and happened to go Hungate Committee in the Stafford-Hungate correspondence, that is what the pipelines rely upon is the history of their standards. They picked up correspondence and attachments to a letter to Congress which immediately turned out to be wrong. They had to be corrected substantially. There were no footnotes as to what was meant by these words "return on investment".

What investment were they talking about?

It took an accountant, Mr. Geeter, to go through and analyze and see what the numbers really were. I would suggest Mr. Geeter could well have spent his time telling this Commission what the capital structure of these companies are, what their actual return on equity will be under these protested rates.

The Commission's considerations, quote,"considerations of consistency and fairness", require that we adhere to our previously recognized criteria in investigating the rates of particular pipelines at the present time. 8 percent on valuation ends up with a $3.87 rate.

Admittedly, we took an analysis that looked at the capital structure and we came up with a weighed average of about $3.98. That's what they would be if they weighed it out, That's in contrast to $6.20 of the pipelines.

We are talking about some irreparable injury. And I would like to go back to one further quote. Mr. Walberg wrote a book some years ago, published by the University of Oklahoma Press. I had occasion to look at a page out of it, page 53, University Oklahoma Press, George F. Walberg, quote, "The monopolistic potential created by an extreme spread between pipeline costs and tariff rates were brought to the attention of the Interstate Commerce Commission during the hearings in the reduced pipeline case, quote," -- here he

is quoting and I quote his quotation, "'the margin between the cost of pipeline transportation and the public rate must be narrowed or else those refiners who do not own pipeline will be forced out of existence'", close quotes.

I thank,for that quote, Mr. Lansdale's client because this was the joint brief filed by Standard Oil Company of Ohio and the National Refining Company in the reduced pipeline rates and gathering charge case. In that case, the Commission made it clear that they would not look at the parent companies. They would regulate the individual.

I guess I have used my time. Thank you.

Commissioner O'Neal: Thank you. At this point, we will take a luncheon recess until 1:30.

(Whereupon, a luncheon recess was taken.)

AFTERNOON SESSION

(1:30 p.m.)

Commissioner O'Neal: All right. According to the list that I have, Mr. Kaplan of the Department of Justice, is next.

Mr. Kaplan: Mr. Chairman and Members of the Commission, my name is Donald A. Kaplan. I am an attorney with the Antitrust Division of the United States Department of Justice.

The Department of Justics --

Commissioner O'Neal: Are you reserving any time for --

Mr. Kaplan: I am sorry, sir. Yes,I would like to reserve five minutes.

Commissioner O'Neal: Five minutes for rebuttal. Go ahead.

Mr. Kaplan: Now, the Department of Justice comes before you without any personal economic interest in this proceeding. Our only interest is that the national energy resources be developed in a most efficient, a most economical and most competitve manner.

In a sense, I come here representing our national energy policy. It is for this reason that, when we spotted what we thought was a restraint on that economic, efficient and competitive development, we felt that we had to move against the tariffs -- the proposed tariffs filed by the TAP's owners.

Let me address myself, first, to a point where I think the Antitrust Division should be particularly competent to

discuss, that is, what will the effect be on the competitive development of North Slope oil? There are a number of different figures as to what oil is available. We know, and we are fairly certain, that there are about 10 billion barrels recoverable in the Prudhoe Bay Field, but there may be up to as much as 35 billion more barrels available for shipment to the Trans-Alaska Pipeline System.

Well, if the potential developers have to share as much as $2 of the wellhead price with the pipeline owners, you can imagine who would be the principal developers of that oil; the Trans-Alaska Pipeline System owners. And if each owner has to pay $2 of the wellhead price beyond his share of the pipeline, you know in what proportion they would develop North Slope oil in a lock-step fashion of their TAPs percentages.

We have heard some claims today that the Prudhoe Bay Field -- interests of the owners of the Prudhoe Bay Field and those of TAPs are somewhat different. I think that that refers principally to about 5, and maybe 3 total percentage points.

The greatest obvious difference between BP and Sohio, I think this Commission can completely disregard. If Prudhoe Bay Field is successful and TAPs is successful, BP will own Sohio in a few years.

The Trans-Alaska Pipeline System is a natural monopoly. It is an absolute monopoly. It is, in fact, perhaps a legal

monopoly since it is somewhat unlikely that a second pipeline would get a permit to be built through that zone of Alaska.

The law is -- the Antitrust Law is quite clear about how you treat such natural monopolies. They must treat the public and competitors fairly. They must not charge monopoly profits and take advantage of their natural monopolies.

I am sure the Commission is aware of the famous terminal railroad case. Well, if there was ever a bottleneck developed, Trans-Alaska Pipeline is that bottleneck.

I don't know with whom these carriers suspect they would be competing for the shipment of Alaska oil to Valdez Marine Terminal or anyplace else. I think it is quite clear that any oil within a reasonable radius of that pipeline will flow through the Trans-Alaska Pipeline System when it is developed.

This restraint on development of North Slope oil will potentially delay that development, delay it, of course,as long as the TAPS owners would like it to, perhaps for many years. Even if this Commission promptly proceeds to consider the challenges,the protests by the Protestants here, the proceeding will take very long. There are very complicated issues which should be considered: the cost overrun issue; the proper treatment of taxes; of depreciation of the removal fund; the proper rate base. Shall it be valuation or shall it be net prudent investment or some other standard?

Of course,those issues are not before you now,and we do

not say that they are. In fact, we say they specifically are not before you. But the proceeding is liable to bea lengthy one. Mobile predicts it will take years. Without a suspension those years will be years in which North Slope oil is not developed. And I think there is no question that this country is in dire need of the most efficient, economical and expeditious development of its crude oil reserves.

But the carriers say we will never be able to recover that $2, or whatever the profit figure is, if the rates are suspended. Well, I submit, Members of the Commission, that Congress took that into account when it provided you with suspension power.

Clearly, if Congress knew that carrier would not be able to recover the charges which it had to forego if a rate was suspended, and Congress determined that this Commission, in its wisdom, if it judged the proposed rates unlawful, would exercise its power very carefull, and only suspend clearly unlawful rates.

Commissioner Christian: Isn't this one reason, perhaps, that the suspension power is only limited to perhaps seven months.

Mr. Kaplan: Quite right. That was my next point. I think Congress balanced the equities by limiting the power to seven months. In fact, the exact period of time has been amended, I believe, four times, or there have been four different periods. And, obviously, this was an issue considered; what would be the appropriate length of time.

Initially, it was a very short period and the Commission said it could not possibly deal with some of these complex issues in that short a time so the period was lengthened. Seven months -- I do not know the merits of the seven-month period but, obviously, in deciding that period, Congress

determined that -- that way, Congress determined it would protect the carriers.

We also hear from the carriers that if you suspend these rates, they may not file new ones. They may let the line lie empty and not use it. Some of them don't come out and directly say so, although our friend from Sohio did. In fact, he said, "It's a strong possibility that if these rates are suspended, the line will be one long empty cannon".

Well, I submit, Members of the Commission, that what he is saying is it would be long empty cannon pointed at this Commission. You should not be so intimidated. These carriers are not going to fail to operate this line. They will come back with lawful tariff, if you suspend.

I hardly imagine that the very powerful interests which hold their debt are going to permit these companies to forego the revenue or going to give them a vacation on their requirement to pay back that debt when tariffs are available which pay off all the expenses, including the debt, and return a generous amount on the equity; nor will the companies or the parent company stockholders permit the line to lie empty.

I can imagine the corporate derivative suits which might occur if they make that decision. But there is another factor too. If we find on Friday, or next Monday, or whenever, that these carriers -- that none of the carriers have decided to file new rates, that they all have, in fact, decided not to

operate TAPS, pending the determination of this proceeding, I submit that such a situation would raise serious questions under the Sherman Act.

There is another potential problem --

Commissioner Brown: Would you expound on that just a little bit for me?

Mr. Kaplan: Well, in such failure or unanimous failure by tariff or filed tariffs or not even unanimous, but any failure, with the result of an agreement on the part of these owners not to use the line, in order to coerce the Commission into granting them higher rates or perhaps coerce Congress into-- force Congress into perhaps taking jurisdiction away from the Commission, that would be an issue which could raise anti-trust consequences.

Now, of course, this is not an easy question, and one that could not be examined in this oral argument. There are a number of doctrines about dealing with public bodies.

But I submit that there would be questions raised which perhaps should be examined.

Commissioner Stafford: Do you think the anti-trust people would take action against them if they did that?

Mr. Kaplan: That I cannot predict. The anti-trust division would not take any action unless the anti-trust division was convinced that, in fact, an illegal conspiracy, which was not the subject of any defenses, had been committed.

Commissioner Stafford: Do you think anybody -- one of the representatives, to your left, indicated that based on a re-fund provision that no one would be hurt. Is this your

judgment or what do you think?

Mr. Kaplan: Well, we strongly disagree, or we strongly take issue. He might be successful at convincing the Commission that the State of Alaska, perhaps the native fund,would not be hurt.

However, the United States, the people of the United States, would be hurt, because for as long as those high, inefficient, excessive tariffs are in effect, development of other oil resources on the north slope would be delayed.

And that is the public interest. And there is no way of refunding time. I wish there was but there is not.

Commissioner Hardin: Do you take the position then that the Commission does have the power to suspend?

Mr. Kaplan: Quite clearly.

Commissioner Hardin: Do you take the position also -- what is your position with regard to the Commission's power to prescribe the level of the rate.

Mr. Kaplan: The Commission, of course, does not have power to prescribe rates. But the Commission need not prescribe rates and suspend this tariff.

The carriers have an obligation to file lawful rates. Your suspension order simply gives them leave to file lawful rates and I submit there are some very good standards out there of what lawful rates should be. You have the reduced rate pipeline case of 8 percent to total capital. This was

recently affirmed in Williams Brothers.

Also in Williams Brothers there is perhaps an argument that 14 percent return on equity plus whatever is necessary to pay off the debt would be permissible.

Of course this standard would give the carriers more revenue than 8 percent on total valuation, assuming valuation is about $9.7 million.

The Department would be willing,or the Department probably would be reluctant to challenge rates based on an argument such as that in Williams Brothers or 14 percent return to equity and a return to debt sufficient to pay off the debt, because that is somewhat of an arguable standard. It's not necessarily the standard the Commission would determine after a full investigation but it is, at least, the arguable limits of lawfulness. And, of course, similar returns to equity would, I would submit, in return to pay the debt, have been ruled proper by your brother agencies. For example, recently, the Federal Power Commission, December 1976,said a 13.5 percent return to equity was appropriate. That's the Natural Gas Pipeline Case.

Also in 1976, the Federal Communications Commission said a 12 percent return to equity for American Telephone and Telegraph would be proper.

14 percent return to equity is within the zone, not a 14 percent return to total capital. That's at least one and one-half times what would be a proper rate. But a 14 percent

return to equity would be sufficient.

If I may comment on the Moss Case cited by the Respondents here, well, the Moss Case ruled that the CAB could not prescribe rates. CAB had made no prior rulings as to what the proper rate of return for air carriers was.

This Commission has. In fact, later, the CAB, after the Moss Case, instituted the domestic passenger fare investigation, in which it determined that 12 percent return--a 12 percent return was lawful for air carriers, and subsequently, and uniformly suspended any rates filed which exceeded 12 percent.

Recently, on June 23rd, 1977, faced with a return of 12.4 percent, the CAB suspended that rate.

This Commission has made statements with respect to what would be maximum lawful rates for pipelines. It simply can suspend and rely upon these carriers to take advantage of the maximum lawful rate. They seem to be having no problem taking advantage of perhaps a maximum unlawful rate.

Commissioner Murphy: Mr. Kaplan, wouldn't it be possible for the Commission, however, to go a step further? If they decided that the rate should be suspended, with a proviso that, based on what we have before us and all, that we are suspending that with the opportunity of filing a rate not to exceed the given amount based on what facts we have here -- could be published.

Pending the investigation, the other rates have not been ordered cancelled, but they would still be under investigation.

Mr. Kaplan: I believe that such an order would also be lawful. I believe that would constitute a ruling by this Commission as to what the maximum lawful rate could possibly be, given the undisputed facts and accepting carriers cost.

Commissioner Murphy: It would be the maximum rate at that time pending the outcome of the investigation.

Mr. Kaplan: Well, of course --

Commissioner Murphy: Because you have so many differences of the eight carriers here. I don't think any of them come out just right.

So, wouldn't it be worthwhile, or to the advantage of the public too, to say if we are suspending these pending the investigation, they will accept the rates not to exceed the given amount for entering.

Mr. Kaplan: I believe such an order would be lawful, as I said, if it is based upon the figures for operating expenses,

for debt expenses which are not in dispute. The Department, in stating what it believes a maximum return -- and we are not suggesting these rates; we are saying what a maximum return would be -- use the carriers' figures.

We do not dispute a single one, even though we may do so in the proceeding. We do not dispute anything about whether or not all costs are prudently incurred. And we suggested what maximum rates would be on that basis.

If the Commission were to do the same thing, I believe such an order would be lawful, and would be upheld in the appellate court.

Commissioner O'Neal: Your answer depends on a different reading, I take it, of what the proper debt equity ratio is, as far as different --

Mr. Kaplan: That's a very interesting --

Commissioner O'Neal: Okay.

Mr. Kaplan: That's a very interesting question. The carriers have come here and warned the Commission that they have no power to make factual investigations; they have no power to go beyond the record; this is not an evidential proceeding; all we have is unsupported statements by the Protestants.

Well, similarly, I would caution the Commission that on suspension proceedings, it should not go beyond the stated debt equity ratios of the carriers. They have made a

determination, what the specific carrier -- whether it be Exxon Pipeline Company or Mobil Pipeline Company -- what that debt equity ratio shall be. That is what should be before the Commission.

If at some other time, in a future proceeding or in this proceeding, the Commission says, "Well, we'll take a look at the total capital structure of the parent" -- well, that might be appropriate for a full investigation.

But there is no information before this Commission right now, what the capital structure is, or the true capital structure is of ARCO or Exxon or any of the other carriers. We have a couple representations. But there is no question as to what their interest costs are. And there should be no question as to what their costs of the pipeline are.

But with those accepted figures -- and the Department accepts them for this proceeding -- the Commission can rule that rates in excess of those of the maximum rates determined by the Department are unlawful.

Also, I believe the method of calculating the rates has been determined by the Commission as well. We had citations to a statement by former Attorney General Levy, a letter to Congressman Hungate, statements by the FTC about what this Commission does.

Yet, the latest statement is the statement of this Commission itself in Williams Brothers. And it's quite clear, by the

calculations in Williams Brothers, that this Commission did not double dip on debt, did not let these carriers make a return on the money that was theirs and the money that was not theirs.

This point was conceded. They call Williams Brothers an anomaly. I think Williams Brothers is a proper rule. I think it's the proper recognition of the Commission as to what a maximum return should be.

In that case, Williams was allowed -- or the rates which Williams charged were determined to yield a return for valuation of approximately 8.5 percent, which was within the 10 percent for petroleum products pipelines allowed by this Commission in its early precedence, which it specifically reaffirmed, of course, leaving the more difficult issue of what the rate rate should be and what the rate of return should be to Ex Parte 308.

I think that for the purposes of this suspension proceeding, the Commission should similarly rely upon the law, its law, Williams Brothers, in calculating what the rate should be, allowing the return to the carriers their debt cost, as was allowed by the Administrative Law Judge Commission in Williams Brothers, and allowing the 14 percent rate of return which Williams had represented to the Commission was what it needed and what it used to determine its rates.

Under those bases, we have determined that the rates filed by these carriers may be as much as $2 in excess of what would be fair. And there is no possibility, there is no possibility that a legitimate cost incurred by these carriers will not be paid. There is no possibility that there will not be a return to capital. I mean, if there are costs in excess of what they represent them to be in the various papers filed with the Commission over the last two months, well, then, they should come forward and, if those costs are legitimate, we might agree to a revaluation of the suspension order and, perhaps, permit filing of higher rates, but only -- only -- within previously determined Commission rulings.

Now, on this issue of getting a return to money which is not theirs but someone else's, the debtholders, Congress spoke on this issue way back in the -- when it adopted the Valuation Act in 1912. If I may quote from a report, House report on that: "The anomoly has grown up, gradually

and unconsciously, as it were, grown up in the courts, themselves, as well as the Commission's, that public carriers are to be allowed to charge an income" -- they meant "return" there -- "on what they owe as well as what they own." Nobody else in the world, with whom we are acquainted, was allowed that privilege.

While we are now in 1977, the carriers want to go back to what the situation was before 1912. The Department believes that standard and good regulatory practice does not permit the double counting of interest. The Department is sure that the Commission would not allow it, as the Commission stated in Williams Brothers.

If I may conclude and perhaps move the proceeding along by not taking all of my time, the Commission is enjoined under the National Transportation Policy to promote efficient, economical transportation services; to promote fairness among shippers and among carriers.

I believe adopting that standard, adopting the Commission's decisions in Williams Brothers and the early pipeline rate determination cases leads to only one conclusion; these tariffs are lawful; that there is harm to the public, let along the individual Protestants, and that the rates must be suspended.

Thank you.

Commissioner O'Neal: Mr. Becker, how many minutes do you wish to reserve for rebuttal?

Mr. Becker: We wish to reserve five minutes for rebuttal.

Mr. Chairman and Members of the Commission, my name is William Becker and I appear on behalf of the Arctic Slope Regional Corporation and with me is Mr. Lewis, who will share our opening time with me. Mr. Lewis will consider particularly the effect of unlawfully high tariffs on the Arctic Slope, including the effect on the Alaskan natives. And I wish to consider just simply two items.

First, the counsel for the pipeline companies have gone to great lengths to explain that the rate of return which they will receive on their equity is roughly comparable to that which is received by private industry on capital invested in capital intensive projects.

These carriers, while protesting that the Commission should not consider return on equity in establishing a reasonable tariff, maintain that the parent companies' consolidated debt equity ratio must be used to impute the amount of equity which is actually in the pipeline project.

They urge that the return on equity should not be based upon equity in the pipeline company alone because all of the debt of the pipeline subsidiaries are guaranteed by the parent companies.

Essentially they are arguing for a flow-through of the

parents' debt equity ratio to the subsidiary.

In support of this position, they refer to the testimony of Dr. Ileo. They refer to Mr. Gary of Morgan Stanley Company. They refer to Mr. Solomon of Stanford, and other experts.

In using this expert testimony, ARCO argues for about a 15 percent return on equity, Amerada Hess argues for a 14.34 percent return on equity.

We submit the pipeline companies are comparing apples and oranges.

A very simple examination of the data upon which Mr. Gary computed his return on equity indicates that his source is Standard and Poors. Standard and Poor's shows return on equity on the basis of a flow-through method of accounting for taxes for book reporting of taxes as reflected in Standard and Poor's as well as throughout the financial industry reflects actual tax rates in effect, not some imputed 52.9 percent tax rate that the pipeline companies are using here.

In fact, the recent SEC filing of Sohio indicates that in 1976, Sohio paid--actually paid taxes of 10.9 percent of net operating income.

In addition, they deferred some taxes. They didn't actually pay them. They deferred them. They got an interest-free loan from the government. And their effective tax rate, including deferral, was 29 percent, according to the SEC filing.

I would submit that the experts to which the pipeline companies make reference are considering these 29 percent tax rates, effective tax rates, and not considering the 52.9 percent tax rate.

Let me move on to the comparison of the position of the Arctic Slope Regional Corporation with that of the pipeline companies, Mr. Cleary for the State of Alaska, and with the Justice Department and the Bureau of Enforcement and Investigations.

The pipeline companies and the other parties to this proceeding have referred variously to Mr. Oaks' method of valuation as reflected in his testimony in Ex Parte 308. And they have also referred to the Williams Pipeline cases.

Mr. Cleary adopts these prior valuation procedures as particularly reflected in the Williams Pipeline Case to justify a $3.87 rate.

The Arctic Slope Regional Corporation maintains that a lower rate, something in the range of $3.20, is justifiable on its face in this proceeding.

Our differences with the State of Alaska relate to several factors. First, it relates to the estimation of useful life. The overwhelming evidence indicates that the useful life of this pipeline is considerably greater than 25 years. Justice Department coun[illegible]eady adverted to the existence of substantial res[illegible]che north slope adjacent to the Prudhoe field and also adjacent to the pipeline.

And we maintain that it is reasonable, particularly in consideration of the useful lives attributed to other pipelines owned by these same carriers through their parents to attributs a 35-year useful life. The effect of this is approximately 24¢ in a reduction on a depreciation if the 35-year life is used and there would be approximately a 3¢ reduction on the amortization of removal and restoration expenses.

Commissioner O'Neal: What is the basis for the 35-year useful life? What kind of research have you done on that?

Mr. Becker: Mr.O'Neal, the various studies that have been conducted on the useful life of the pipeline are referred to rather extensively in the papers that have been filed with this Commission. I believe that the Wainwright survey was the one that indicated that based on existing known reserves -- I mean on existing known fields that are actively being produced, the useful life is 35 years.

The other studies all indicate a lesser useful life based upon reserves that are currently in production. However, it is our position that it is most reasonable for the Commission to assume that there will be other reserves that will be actively produced and, accordingly, a 35-year life is justifiable.

In addition, the pipeline companies estimate throughput at 1.2 percent -- I mean, 1.2 million barrels per day. We, of the Arctic Slope Regional Corporation, indicate that if

the throughput increases to 2 million barrels per day, the result will be a substantial reduction in the reasonable tariff amounting to $1.40.

We also argue that there should be flow-through of taxes which is not included in Mr. Cleary's calculations. I have already averted to the effect without attaching a dollar figure on,and the dollar figure depends on what the other figures come out at. So, it is difficult to attach a dollar and cent figure to it.

In any event, that leads me to the final point and that is that we feel that the Commission is constrained to also consider the potential reduction in cost and reduction of pipeline tariff that would result in the finding of mismanagement. And our calculations, assuming there's a 15 percent reduction in total capitalized cost, would result in approximately a 50¢ reduction in the per barrel price under the tariff.

This Commission and all other agencies are not required doggedly to adhere to precedent in determining matters that are under their jurisdiction. As the Supreme Court recognized in the Chenery II case, back in 1947, it is clear that administrative agencies have flexibility to determine each case as it comes before it and may act on an ad hoc basis.

We consider that the importance of this pipeline involving as it does almost 15 percent, or projected 15 percent of the

nation's daily consumption of oil in the immediate future requires a particularized ad hoc review of the costs that are being charged in the tariff, and we maintain that as long as the Commission carefully explains its deviation from prior cases, carefully explains its reasons for reducing costs, that a tariff in the range of $3.20, on the average, is justifiable.

Commissioner O'Neal: Let me ask you a question there. Do you perceive any problem -- I think you stated this in the pleadings,do you preceive any problem as far as far as the natives are concerned in recouping if it is later determined the rate is too high and a refund is ordered?

Mr. Becker: Mr. O'Neal, if I may defer to my associate counsel, Mr. Lewis, who is going to address those questions, I would appreciate it. Thank you.

Commissioner Brown: I wanted to ask one question, please. I think you mentioned the $2 million barrels a day.

Mr. Becker: Yes, ma'am.

Commissioner Brown: Is that the projection now, or was that an earlier projection? Isn't that considerably lower, now, or --

Mr. Becker: Well, as I understand it, the original projection for the throughput of the pipeline was less than a million barre's. It was, then increased to a million two barrels for the years beginning in 1979, and I believe

the data that has been filed with the Commission's support study. In later years, it is apparent that the throughput will increase to 1.6 million and possibly 2 million barrels per day.

We maintain, on the basis of the enormous energy needs of this country and of the world, that it would be reasonable for the Commission to consider that the throughput in the immediate future over this pipeline will be much in excess of the 1.2 million barrels per day that has been projected by the pipeline companies.

Commissioner O'Neal: It is my understanding that in order for the pipeline to have that capacity, or a capacity greater than 1.2 million, that there would have to be some additional construction of some other pump stations and so forth. Are you including that in your consideration or what?

Mr. Becker: I think that the cost for the additional pumping capacity is reflected in the data that's been submitted by the pipeline companies for the year 1978. And I think our data has not been refined to the point of including the incremental financing costs and the like, as a result of that added capacity. However, in terms of that cost as a percentage of the overall cost of the pipeline is relatively de minimis and I do not feel it would have a substantial impact on on the dollar and cents amounts that I quoted to you previously.

Commissioner Stafford: Explain to me, now, how is it your client obtained whatever funds you are talking about? Is it aside from what the state gets, or is it what the state gives you?

Mr. Becker: Mr. Stafford, if I may defer to Mr. Lewis who is going to consider the impact of unlawful tariffs on the Alaskan natives, I would appreciate leave to do so.

Commissioner Stafford: And he will refer them to whether there is also a problem about whether you have some concerns that we have a refund provision, whether you would get hurt by it?

Mr. Becker: Yes, sir. Thank you.

Mr. Lewis: Mr. Chairman, Members of the Commission, my name is Gale Lewis. I am appearing, also, on behalf of the Artic Slope Regional Corporation.

Let me tell you just a little bit about Alaska that hasn't been presented. Most of Alaska is totally undeveloped. There is, essentially, no road system; no intrastate communications system; there are 127 native villages that have no high schools; there is, essentially, no public health service in the state for native people who constitute approximately 20 percent of the state's population.

Now, the figures have been -- Sohio, I believe, projected that Alaska was going to receive a huge surplus which they really didn't need and, therefore, there would be no irreparable harm to the State from having a deferral from having three or four years of proceedings and then have this $2 or $3 suplus paid back into that period.

Well, let me tell you about some of the things that are

budgeted by the state for that money and why they had to budget it. The budget for 1977 is approximately $850 million. We're talking about a $3-per-barrel fluctuation here, a disputed range of $3 per barrel on the tariff which means $3 per barrel at the wellhead price.

We're talking about approximately one-third of the state's budget. Now, right now, under court order, the State of Alaska is obligated to some $60 million to provide secondary education for Alaskan natives.

There is another $50- to $100- to $120 million which is obligated -- which the state is obligated to put into rebuilding the fisheries which, by federal law, were a part of the resources of the native people until very recently.

So, we're talking already about close to $200 million which the state is obligated, in some cases by court order, to put into the state in the next -- 1977, 1978 and, possibly, 1979. Obviously, deferring the $300 -- $250- to $300 million for three or four years, this is going to allow that -- those services to the native people -- again, under court order -- to be implemented.

So, there is a terrible crunch in the State of Alaska and it is obvious that the native people, as they always have been, will be the last to get the benefit of whatever dollars are coming. So, the native people, 20 percent of the state, have a vital, critical interest merely as citizens of the

State of Alaska, in having the rates adjusted immediately to a lawful and reasonable rate, and a deferral of three or four years of these programs is going to constitute irreparable harm to the natives in the state on those grounds, alone.

Now, let's talk about the Settlement Act just a moment and the compensation that Congress intended for the native people to get in exchange for Prudhoe Bay which the oil industry now has.

The people in Alaska had been -- the native people in Alaska had been existing since Alaska was acquired by this country under aboriginal title which, by federal law, meant that the land was theirs and could be taken only by the federal government. It was good against the rest of the world.

In the Statehood Act, Congress allowed the State of Alaska to select 100 million acres of land but reserved land used or occupied by natives. The state selected Prudhoe Bay; a conflict arose; the Secretary of the Interior then told us to freeze on any further land selections. Congress then settled the native claims by taking from them the lands where they had lived, giving those to the oil industry and giving them additional lands as compensation.

The Arctic Slope got approximately 4 million, 4 to 5 million acres, [illegible] surface right, outside of CAT-IV and outside of the traditional Arctic Slope land, as compensation. That land is absolutely worthless unless there is oil

-- unless oil is on that land.

Now, it's obvious that it's a price of the wellhead oil is driven down by the tariff, that the incentive to anybody to come in and invest in the exploration necessary to discover that oil is lost. For $4 or $5 a barrel, nobody is going to come into the Arctic Slope, pay the Arctic Slope people the money that -- lease payments to them for the right to go on and explore and develop the oil.

Oil will not be developed there and their land, until sometime well in the future, will give them no return at all. So, in exchange for Prudhoe Bay, they were given land which is valuable only if the wellhead has value. Tariffs drive that down immediately.

The jobs, the standard of living and all those kinds of things that are dependent upon additional exploration by non-TAPS related companies is very apparent. And that is the second irreparable harm, it's the anticompetitive effect.

The high tariff will pose the entry barrier which will prohibit anyone not connected with the present TAPS owners from making the investment in the Arctic Slope that's necessary to realize for the native people their land.

Now, I've talked only about 4 or 5 million acres of subsurface land on the Arctic Slope. All of the Alaskan natives share, through another provision of the Settlement Act, in up to 70 percent of the revenue that would be derived by the

Arctic Slope Regional Corporation from their land.

So, all of the native people and, particularly, the Arctic Slope people, have, in effect -- their economic future is tied up in their hopes and in the expectation that given an adequate wellhead price today, non-tax related companies will come onto the Arctic Slope and search for and develop the reserves that are thought to be there.

Now, there was a question about the third interest is payments in the Alaskan Native Fund. Now, a deferral of the reduction in the wellhead price--$3 reduction in the wellhead price as a result of unlawful tariffs defers for some 13 years, for an additional six years, that the payout period under the Alaska Native Fund, that's going to constitute an absolute loss of some $60 million, and it's not the kind of thing that can be compensated for by a payment four or five years from now.

The time for the action in Alaska is now. The native corporations are struggling to establish themselves right now to develop their resources, provide basic education and that type of thing for their people today, and a three- or four-year deferral simply -- with inflation and the other things, the cost of living and development in Alaska such as they are -- [illegible] deferral with a refund provision at the end of t[illegible] is not going to it whole.

Children who go for another three or four years without a high school in their town and who have to spend nine months of the year in another city will not be compensated by a refund provision that gives them a high school four or five years from now.

Has that answered the question that the Commissioners had, up to that point?

Commissioner Stafford: Thank you.

Commissioner O'Neal: You are saying, if there is a refund provision and if the money finds its way back to the natives, it's still not enough?

Mr. Lewis: Well, it's not enough because --

Commissioner O'Neal: Because of the deferral in time?

Mr. Lewis: The deferral right now, both in the native fund for the development of their own land, their own resources, their own ability to have jobs now, to work on the crews that do the development, to participate in the development of their own land, would be deferred until the wellhead value is sufficient to induce exploration.

And none of these things --

Commissioner Stafford: About how many people are involved in that?

Mr. Lewis: Approximately 85,000, 90,000 Alaska natives. That's approximately 20 percent of the State's population.

Commissioner O'Neal: Thank you, very much.

Let's see. The next witness is Mr. Greenberg for the Bureau of Investigations and Enforcement.

Mr. Greenberg: Good afternoon, Mr. Chairman and the Commission. My name is Edward Greenberg. I am representing the Bureau of Investigations and Enforcement.

I would like to reserve, with the Commission's indulgence, ten minutes for rebuttal or re-rebuttal time.

Commissioner O'Neal: Ten minutes.

Mr. Greenberg: Before getting into my argument proper, I would like to introduce Mr. Peter Shannon, the Director of the Bureau of Investigations and Enforcement, who will respond to a question that was originally raised by Commissioner Christian.

Mr. Shannon: Mr. Chairman and Members of the Commission, this morning Commissioner Christian asked the attorney for the State of Alaska--I believe two other Commissioners, Commissioners Hardin and Murphy, during the course of oral argument, have alluded to the same type of question -- as I understand your question Commissioner Christian, you asked what if the Commission suspends without prejudice to filing rates, lower rates, and what if the oil companies do not file lower rates -- what then could the Commission do at that time?

Well, I suggest that there are three avenues of approach that the Commission might want to use, might choose to use. Before describing, very briefly, these three approaches, I'd

like to refer the Commission to the fact that four oil companies, Sohio, Exxon, ARCO, and I believe Phillips, are already common carriers, subject to the jurisdiction of this Commission.

I also have been informed that the other Respondents, save BP, have interest in oil pipelines through affiliates. And I know that all the Respondents have voluntarily submitted themselves to the jurisdiction of this Commission by filing the instant tariffs.

With this as a background, I'd like then to refer to Section 14 of the Act. It states as follows,"it shall be the duty of every common carrier, subject to this part, to provide and furnish transportation upon reasonable request therefor.

I submit on behalf of the Bureau of Investigations and Enforcement that because these oil companies are common carriers, subject to the jurisdiction of this Commission, that they are obliged to transport the oil in question.

And should they, hypothetically, refuse to come before the Commission with lower rates, assuming there is suspension without prejudice, then the Bureau of Investigations and Enforcement would proceed immediately in Federal Court to enjoin them from their failure to perform their duty as common carriers, that is, to transport the oil.

This is the first avenue of approach.

The second [illegible]uld be for the Commission to decide but there are possible approaches.

The Commission has been charged under the preamble to the Act of the National Transportation Policy referred to by the attorney from the Department of Justice -- the Commission is charged with the duty to encourage the establishment and maintenance of reasonable charges for transportation services.

And it is my informed opinion that the Commission itself could proceed in the Federal Court and ask for an immediate and permanent injunction against the oil companies for failure to perform their duty as common carriers.

A third approach, which is also for the Commission to decide, is that this Commission, I believe, assuming failure to submit reasonable rates, reasonable tariffs -- this Commission itself could order the common carriers to perform their duty to transport the oil under reasonable rates.

And if there is failure on the part of the oil companies to do so, then, again, I believe the Commission could proceed immediately in the Federal Court.

We would provide our services of this Bureau, hopefully with the Department of Justice, alone if necessary, to enforce the Commission's order.

Now the argument in the case today on behalf of the Bureau of Investigations and Enforcement will be presented by Mr. Greenberg. [illegible]ere are any questions on these three possible approaches that I suggest, I'd be happy to entertain them before turning over the podium.

Commissioner O'Neal: How would a rate be determined in those cases?

Mr. Shannon: How could a rate be determined?

Commissioner O'Neal: Yes, what rate would you --

Mr. Shannon: Well, we submitted -- and of course, the other Protestants have -- we submitted -- and we believe we have the documentation therefore -- we submitted what would be a reasonable rate, so the Commission could suspend the rate without prejudice to submitting a rate not to exceed the reasonable rate predetermined.

Commissioner O'Neal: But you would be seeking performance under the rate as the Commission determines, first of all --

Mr. Shannon: We would be seeking -- if we went in as a bureau, into federal court, we would go in for a permanent injunction, asking the court to order the oil companies to perform their duty as common carriers, and that is to transport the oil.

Once they are common carriers -- since this Commission knows, in the reorganization, you have entrusted to this bureau the enforcement of adequacy of service. And whether it's motor carriers who've failed to service the towns that they're committed to service, or whether it's the railroads, we are to go in and enjoin them, to make sure that they do adequately perform their duty of service.

We submit that the same applies no less to the pipeli-

the oil companies.

Commissioner Hardin: The level you are talking about, then, actually would be tantamount to being a reasonable maximum. Is that what you're talking about?

Mr. Shannon: That's right. That's what you referred to earlier, Commissioner.

Commissioner Christian: I assume that, since this would only occur -- this entire scenario under your three options would occur only after the Commission had previously issued an order suspending without prejudice to a particular level -- that it's that level --

Mr. Shannon: That's right, Commissioner.

Commissioner Christian: -- that all of these options would be directed to.

Mr. Shannon: That's right. That was a hypothetical -- I didn't explain myself clearly -- that was a hypothetical I thought you opposed earlier.

Commissioner Christian: Right.

Mr. Shannon: Thank you.

Mr. Greenberg?

Mr. Greenberg: Thank you.

I guess the first question to be addressed is why is the Bureau in the case? Simply stated, it's because the rates are too high.

We have estimated that in 1978 the overcharges which will

accrue to these carriers will exceed $600 million. We don't quarrel with their expenses. We don't quarrel with any figure at all that they have offered in support of these tariffs, with the exception of one item.

Several of the carriers have dreamed up a figure of $4 billion as the removal and restoration costs, whereas the remainder stick with a study which has not heretofore been published, and has not been presented to this Commission, in the neighborhood of $1.049 billion.

There has been no explanation insofar as where the difference between that particular item, so we have stuck with the $1.049 billion. For the purpose of this argument, we are even going to withdraw from our protest position of the service life of 27.5 years. We believe that the situation and the entire presentation can be better presented to this Commission by addressing the standards on the ground rules that these carriers have established.

The difference in our argument is how have they computed their rate of return? And I suggest that the best way of approaching this entire problem is by reciting one portion from Mr. Flynn's brief on behalf of Exxon.

"The Commission's role in this suspension proceeding is relatively simple. In exercising its discretion to suspend or not suspend, all that this Commission could do is to examine the rate filed by Exxon to determine whether or not that rate

has been established in accordance with the practices conventionally accepted by this Commission.

"If it has been, the Commission should refuse to suspend the rate, leaving the Protestant and other affected parties to pursue the remedies under the Act."

Mr. Flynn, of course, doesn't add that if they had not filed their tariff in conformance with those procedures, the Commission should, in fact, suspend.

We will show that these procedures have, in fact, not been followed. The result of this exercise, which is a departure from all known precedence, all established ratemaking standards and logic, is that these carriers will reap the windfall of the 40 percent return on equity in 1978. Using Commission established procedures, they are receiving a 13 percent return on valuation, as the Commission has historically accepted that concept of return on valuation.

Further, as throughput increases as indeed it will, and as economies of scale occur, the windfalls will increase. For example, in the handout which I have given to the Commissioners and all Counsels, on Exhibit 6 we have charted Sohio's future experience in this line.

And it can be seen, on page 1 of that exhibit, that Sohio's return on equity by 1980 will approach 200 percent. We suggest that the public interest cannot abide such a result.

The second reason we are in this case is because this is

a unique case. In addition to the ratemaking question which is here before you today and the level of rates, the Commission has the responsibility to undertake a valuation under Section 19A. This valuation process has been going on for some time, in the form of investigation being conducted by the Bureau of Accounts and their consultant, Touche Ross.

And we will discuss in a few moments the fact that it is our position here that the oil companies and their agent Alyeska have not given the full support to that valuation which is necessary. And it is only with the timely completion of that valuation that this entire proceeding can be closed once and for all. Until that valuation proceeding is concluded, this case will have to remain open.

First let me just say it is certainly our position that the Commission has the power to suspend. There can be no doubt about it. The statute clearly says it has the power. We suggest and argue that the Commission not only has the power but it must suspend because, in addition to the arguments that we've heard today about the stifling impact upon competition, the restriction of production and the inhibition of new exploration, all we've been talking about is the exploration for approving gas reserves.

In Exhibit 1 of the handout we've given you there is also exhibited oil reserves. We also have gas reserves of 99 trillion cubic feet. This is estimated by the U. S. Geological Survey. Unless these reserves are fully exploited, we're not only facing an oil short-fall but also a gas short-fall.

The Bureau is asking for a suspension of the present rates and an investigation of whatever rate ultimately comes out of this particular proceeding. We will suggest that the carriers be granted special permission to refile on short notice, if they, first, use the proper methodology which has been established by the Commission and conform with the classical ratemaking standards;

Number two, if they agree to produce the documents and not interfere with the orderly process of the valuation proceedings; and, number three, if they agree to refund to

shippers any overcharges later found to occur at a rate of interest not to exceed -- not to be less than nine percent.

We have heard today that the carriers have agreed to an eight percent return -- eight percent on any refunds. I don't understand where the eight percent comes from, but I guess because we have chosen nine, they have chosen eight.

As the Hope Natural Gas case makes very, very clear, the theory of return on valuation is an attempt to reimburse carriers who have dedicated their investment to the public use, their return for their entire investment.

That investment is not just their cost of -- it's not just their cost of equity, but is also their debt cost. The difference between the Bureau of Investigations and Enforcement and these carriers is the way these carriers have treated interest.

Now, I would like to turn your attention, please, to Exhibit 2 of the exhibits, and here we set forth the formula, on the first half of the page, on how the Commission has historically treated valuation and rate of return on valuation.

The question is, shall the Commission allow the pipeline companies the opportunity to earn up to ten percent of valuation which is the highest the Commission has ever historically afforded any regulated carrier, according to that established formula, which is you take the interest, the cost of interest, and the after tax return for equity, divide that by the

valuation and you come up with your rate of return for valuation. The highest ever given by this Commission is ten percent; or, the question that the carriers would like to have you answer is, shall the Commission, for the first time in any reported case, allow the carriers to earn as much as seven percent valuation just for equity.

According to a formula, it is never approved for pipeline ratemaking purposes. The only support for this is one unreported case of an Administrative Law Judge which can be readily extinguished.

The impact of how you treat this formula is the extraordinary returns on equity that we've spoken about. Now, one point that's been mentioned by -- and I believe, again, it was in answer to a question by Commissioner Christian is, how do you treat the debt equity ratio with regard to the parents? Which debt equity structure do you talk about?

And I don't recall -- I think it was Mr. Lansdale indicated that in the AT&T cases, it has, in fact, from time to time, the various regulatory agencies have looked at the parents' debt equity structure.

I would like to read a short statement from Principles of Public Utility Rates by Professor Bonbright, from Columbia University. "But if the existing security structure is clearly unsound, or is extravagantly conservative, the rule must be modified in the public interest. Actual cost of

capital may then be disqualified in favor of legitimate cost. Thus, in post-war rate cases, the operating subsidiaries of the American Telephone and Telegraph Company have defended the objective of a one-third debt ratio for the consolidated system, whereas various non-company witnesses, including myself, on occasion, have argued that a somewhat higher debt ratio would be justified." This is at page 244.

The meaning of this is that while it is true that various agencies have, from time to time, looked at the debt equity ratio of the parent, they have done so only to minimize the impact of the rate upon the public, not to exaggerate its impact.

We suggest that only by deducting the interest from the operating expenses, which they have done, can they hope to persuade this Commission they have stayed within the historical guidelines of rate of return on valuation. It is the only way they can do it.

Now, you can see, on Exhibit 5, we have extracted from Exxon's tariff, from their reply brief -- and, by the way, the last two lines of that page, we have inserted, those are not from Exxon -- they have indicated a return on valuation of 7 percent. Well, as we have heard today, this is a concept of comparing apples with oranges. This is not return on valuation, as the Commission understands it. This is return on valuation without accepting or understanding what the cost of attraction of debt capital is. So, we've got 7 percent return on valuation that is not return on valuation.

The actual return on valuation that Exxon is requesting is 12.2 percent. That figure you get by adding to their return on equity after taxes, and you add back in the interest expense and you come out with 12.2 return on valuation. That translates into a 49.6 return on equity.

I suggest that the Commission is not going to tolerate this kind of latitude from established procedure. In fact, I guess the carr[illegible]e made an eleventh-hour admission at this time, and have admitted for the first time that's exactly what they are doing.

We have heard them talk about the testimony and the verified statements in their replies from Dr. Gary, Mr. Solomon, Mr. Jeter. Well, these gentlemen understand what we're talking about. They understand that the return on valuation they are seeking is 13 percent. That's what the issue is. They say, "It is 13 percent. It isn't good enough." We suggest this is not the forum that that rate of return standard can be altered. The correct form is either later on in the investigation of this rate or in Ex Parte 308.

Exxon and Sohio, respectfully, make that concession in their briefs, at page 45 for Exxon and page 19 for Sohio. They admit what their rate of return on valuation really is.

So we are through masking where the culprit is. The culprit is, what are we talking about, return of valuation? Where do you treat the interest? The Commission has historically treated interest as a part of the return on valuation. To do so, distorts the entire concept of rate of return on rate base. It just doesn't make any sense.

Now,they have tried to confuse the Commission,and have done a pretty good job of confusing me by trying to talk about this 1941 consent decree. Well, that is actually the second half of that ratio that is on Exhibit 2. That's all that is. But the 1941 consent decree has no relevance to the Commission's practice on ratemaking. That relates solely to restriction on dividend payoff to the owner companies.

We suggest there is no reason to worry about what kind of dividends they are going to pay up to their parent, because they are doing very nicely.

Now, if I can just take a few more minutes before turning it over, I would like to just briefly discuss the question of the record access problem.

There has been no outright refusal of access to the Commission's Bureau of Accounts or to Touche Ross. However, there has been an unusual procedure by which Alyeska and their counsel have been orchestrating the flow of documents and witnesses in a manner which is not consistent with the independent exercise of the Commission's responsibility in this proceeding. They have decided which documents are going to be turned over and when they will be turned over; which people will be interviewed and when they will interviewed.

We suggest and, in fact, argue that Section 19(a), Subsection (e) requires free access to every common carrier for all documents and all personnel. This has not been the case. We suggest that only through an affirmative order of this Commission can we arrive at a cooperative understanding, on the part of the owner companies, as to what their responsibilities are for furnishing this Commission with information necessary to go forward with the valuation.

Thank you.

Commissioner O'Neal: You have more time left. That was an error by the timekeeper. So, if you want to take it, go ahead.

Mr. Greenberg: I would like to back up for a moment then to the Commission's power to suspend which we've not addressed, except on our protest papers.

Now, certain of these carriers have indicated that the cases we've cited are not relevant to this particular proceeding because we're only citing cases where the Commission has decided its power and exercised its power under Section 216, saying for some reason there is a distinction between Part 2 carriers and Part 1 carriers.

Well, for their edification, we'd like to cite a few more cases where the Commission has commented upon or exercised its power to suspend initial rates.

The citations I'd like to give the Commission are Galveston Wharf, 23 ICC 535; Cotton From New Orleans, 49 ICC 751; Rail, Water Grain in Bulk, 321 ICC 564; and Lake Cargo Call, 329 ICC 549.

There is absolutely no authority for the proposition that there is distinction between a concept of new and initial rates.

But even if there was, as to Exxon, Sohio, and ARCO, these would not be new rates.

They've made the argument that what they're really talking about -- in the cases we've cited -- are really talking about is the Commission has exercised its power to suspend new service but has never restricted access to the entry of the

field of regulated transportation.

Well, as to ARCO, Exxon, and Sohio, since they are clearly already regulated carriers, actively participating in currently operating oil pipelines, their access to the field is still quite clear and extensive.

We have not rejected that by suspending these tariffs.

I'd like to talk about the question of irreparable injury.

Now, we've discussed -- it's been discussed and batted around a great deal. The question really is, I guess, is the Commission going to permit itself to be, in the words of counsel over here, blackmailed?

They've tried to turn it around. But that is exactly the situation here. These carriers are attempting to persuade this Commission that there is no rational limit upon how much they can earn. We suggest that public interest cannot accept that concept.

49 percent return on equity is incredible. 200 percent return in 1980 is unbelievable. It's got to be stopped and the Commission has the wherewithal to do it now.

Thank you.

Commissioner O'Neal: What's your response to the argument that if the Commission sets the rates too low that there is no way the pipeline owners can recoup losses?

Mr. Greenberg: Well, number one, we don't think that the

Commission would ever be in the position of setting the rates too low and this is perhaps an argument that I neglected to make.

We are not suggesting, although we included, as Exhibit 9, an itemization of what the rates would be if these carriers were to accept classical rate-making practice accepted by the Commission.

What we are saying is, there should not be a prescription by this Commission. There is no reason for the Commission to prescribe a rate.

All we are asking for is the carriers to refile their rates, consistent with established precedent.

Now, there is the question of recouping losses. Well, by and large, the carriers are only recouping losses that they're going to get from themselves. They are moving money from one pocket to the other.

Now, we've heard BP talk about, they -- I'm not sure which carrier it was -- talk about that they had no particular interest. Nonetheless, they'll be able to move oil. The ballgame is in their park.

Commissioner O'Neal: What about the carrier that owns no North Slope production facilities or areas?

Mr. Greenberg: Well, they're going to be able to take these revenues and explore and I have no doubt that they will, in fact, continue to explore for further oil.

The problem is that it is a balancing of equities. As to that carrier, there is a balancing of equities. We suggest that the public interest is not the one that should suffer.

Commissioner O'Neal: Is there -- going to another area, just to follow up on that -- is there -- or what is your argument for the Bureau not being subjected to the usual discovery rules in this case, as any other party would be?

Mr. Greenberg: Well, the valuation process is not an adjudicative procedure. It is an ongoing proceeding. It is a preliminary step in the Commission's ultimate decision in this particular case. It can only be done in an objective and clear way if there is the kind of clear access to records that is mandated by Section 19(a)(e).

If you throw that out, you throw out the value of a valuation proceeding.

This is not, even this entire proceeding, is not adjudicative. It is clear that this is an informal rule-making proceeding. There is no reason for the Bureau to have to rely upon the rules of practice and proceed and make sure that we have an objective valuation.

Commissioner O'Neal: Well, is your argument that you have a role beyond that of the ordinary witness or the ordinary party?

Mr. Greenberg: In essense, yes, it is. We have adhered to a very close line. We have no axe to grind here although

it may sound somewhat to the contrary.

All we're trying to do is develop a record that is consistent with established Commission precedent. We don't care what the rate is as long it is consistent with Commission practice.

I might just add, I guess it is perhaps a departure from where your question was, if there is no further follow-up to that, Mr. Chairman.

Commissioner O'Neal: Go ahead.

Mr. Greenberg: That is that insofar as the computation of this rate, there is no difference between the method that we are setting forth as the appropriate method and that which Mr. Cleary has addressed today.

I think perhaps Mr. Cleary neglected to add that it is the treatment of interest which is the crux of the situation. How do you treat it? Where does it go?

Mr. Cleary's difference is that he says, he wants an 8 percent return on valuation.

All we are saying here is, they should not be permitted to obtain any higher rate of return than 10 percent, which is the highest this Commission has ever awarded.

Thank you.

Commissioner O'Neal: I guess this would be a good time to recess. [illegible] at 3:00 o'clock.

(Whereupon, a short recess was taken.)

Commissioner O'Neal: It is now time for the pipelines on rebuttal.

Mr. Flynn: Mr. Jordan will speak for the pipelines.

Mr. Jordan: Mr. Chairman, Commissioners, I've always heard stories about what it was like to fight a war on two fronts in Europe and I think I now know how it feels and, perhaps, a little bit more so.

We're not going to try this afternoon to respond to all the points that have been made. Obviously, we can't and, obviously, it wouldn't be productive to do so. I would refer the Commission to the substantial papers that have been filed on behalf of the carriers where a number of these points were dealt with in considerable detail.

At the outset, I would like to put my ARCO Pipeline Company hat on for just a moment to clarify one point. Mr. Lansdale made a reference to the inclusion of the refund provision in the tariff. I think he indicated that everyone had agreed to that, or at least that is what I thought he said. That may have reflected a slight misunderstanding.

ARCO Pipeline Company is considering that as a course of action, dependent largely on what the Commission does. We have not rejected it as a concept, we do have it under active consideration [illegible] not received the approval of management to say that we are at liberty to include such a refund provision. I just wanted to make that clear so there wouldn't be

any misunderstanding about the positions of the various companies.

As you know, some companies have said here today that they interpret the reparations provision, essentially, as flowing through and others have not said that. There are, obviously, matters of interpretation here on which the answers are not entirely clear.

I would also like to, just in passing, say that I think the Commission ought to give serious consideration to the propriety of the Department of Justice 11th hour submission. I note that their original submission, which we got in the form of a protest, amounted to about 11 pages. All of us arrived here this morning to find a 47- or 48-page reply brief. That sort of inverts the normal relationship between your main paper and your reply brief and I think it is inherently unfair. And since the Commission rules do not provide for that -- I realize it's within the discretion of the Commission -- I think that's a factor that ought to be taken into account and I don't really think it's important in terms of the substance of what has to be determined by the Commission on a very short schedule.

Let me just say one thing about the initial tariff point and the power to suspend; there are cases in which the Commission has suspended what we will refer to as initial tariffs. The new cases that were cited by Mr. Greenberg, I think, were

all cases that had been cited in one or several of the carriers' briefs.

The point on that is simply this; we have been unable to discover a single case in which a suspension of an initial tariff came about in such a fashion as to effectively deny the service in question. In other words, there are other ways the traffic could move; there are other circumstances which allowed traffic to proceed.

We have not been able to find a single case in the Commission involving the suspension of an initial tariff which is comparable to the case that's here today. And as someone pointed out this morning or asked in a question, there just aren't any cases on this. No court has decided this. And the arguments which we make are based on the analysis of the statute and on a rather extensive interpretation of the legislative history which is contained in the Mobil brief.

I would like to say just one thing about the Moss case.

Commissioner Hardin: Are you saying you would refuse to move the oil if some rate below that which you have filed is --

Mr. Jordan: We're not saying that, Mr. Hardin. We're not saying that at all. Each company is ultimately going to have to look at its own economics, which vary, to determine what it would do based on what the Commission would do. There is obviously a difference between those companies that

are in the pipeline business and don't have any oil and those who are in the pipeline business whose affiliated companies do have oil.

I can't say what the response would be. We're certainly not saying that -- to this Commission, the oil will not move. That's not what's being said here today.

Now, with respect to the Moss Case, it seems to us there's been a lot of sort of very skillful footwork around that case. I don't think any of it has been successful in sidestepping what was said in the Moss Case. The Moss Case, essentially, said that you cannot use the suspension provision as a club to prescribe tariffs.

Now, as I read all of the suggestions which the Commission has gotten from Protestants, they are, essentially, not that there be a bare suspension but that there be a suspension with a suggestion. And it is our argument that the suspension, coupled with a suggestion is precisely the kind of action which the D. C. Circuit found was improper in similar circumstances in the Moss Case.

Commissioner Murphy: Wasn't there some distinction in that didn't the -- in the Moss Case, the rates were ordered cancelled, I believe in that case. And they prescribed the rates to take effect in lieu of those rates, wasn't it?

Mr. Jordan: Well, I don't think there is any distinction that is significant. There are differences between the Moss Case, in terms of the history, the prior history of the Moss Case.

Commissioner Murphy: We are speaking here, though, of ordering the rates cancelled and these established in lieu of them. They are being suspended and being put under investigation, whereas in the Moss Case, as I recall it, those rates

were ordered cancelled, period, and these are going to be new rates, in what they prescribe, and the court said there, you ha no basis to prescribe rates for the future. But we are not talking about that part of it here, or I am not.

Mr. Jordan: The proper element is the suggestion, a suspension coupled with a suggestion that rates at a different level would be acceptable. But the Interstate Commerce Act does not give the Commission the power to prescribe rates without a full hearing. I think that is our point.

Commissioner Murphy: Let me be straight on mine. I am not saying we would prescribe the rate but on the record of the information that you have given us, the information that we gotten from the other parties, we are coming to as near a satisfactory conclusion of what the rate would be, tentatively assessed, until we can complete the investigation.

Now, if you are going to put the information here that we can go on, unreliable, or something of that nature, it is part of your blame as well as, maybe, some of ours.

Mr. Jordan: I would like to be very clear on this point. It is our position that this is not an evidentiary proceeding. It is our position that this is not an appropriate proceeding in which to receive evidence and try to make judgments which involve deviations from prior Commission practice. This is a suspension proceeding, and one can argue about whether the Commission has the power to suspend at all,or not, under these

circumstances, but let's assume for the moment that the Commission does have that power to suspend. What we are really saying is, "Okay. You can suspend if you have that power", but what you cannot do is you cannot suspend and say, "leave the file on one day's notice of tariff at these suggested levels." That is tantamount to prescribing a rate. It is particularly tantamount to prescribing a rate with the economic cohersion factor involved here with $9-plus billion of assets lying fallow. That is, effectively, in economic terms, the prescription of a rate.

Commissioner Christian: Are you relying on any other case other than Moss against CAB? The reason I ask that is my recollection is, a number of cases since that time have distinguished Moss to the point that I really have great difficulty in finding Moss applicable, myself. Are you relying on any other cases?

Mr. Jordan: Well, there was a reference to this in the Scrap Case, as well. Now, I recognize that that was Judge Wright quoting Judge Wright, I believe.

Commissioner Christian: I believe it was also referred to by the Supreme Court in overturning Judge Wright's decision in the Scrap Case, too.

Mr. Jordan: That's right. But I think that there are not a great many cases in this area, and the reason is that it is generally recognized that this is not an appropriate

way to proceed. It is not an actively litigated area. There's not a lot of case law. The Moss Case is really the landmark case in this area and I think it is one that the Commission will certainly have to give consideration to.

Commissioner O'Neal: But, aside from the question of whether this is putting aside the initial rate question, the Commission has done this in the past with other kinds of rates and it has suspended without prejudice to refiling at a lower rate. And you don't know of any case that says the Commission can't do that.

Mr. Jordan: In terms of ICC procedure, I do not know of any case.

Commissioner O'Neal: We are talking about suspension here. We are talking about a different kind of standard. As it has been stated, I think, is there reason to believe that the proposed rates will be found, after a full investigation, to be unjust and unreasonable or unduly discriminatory? And you are saying that even if the Commission finds that to be the case, it can't indicate what would be a reasonable maximum rate?

Mr. Jordan: Well, there's a range of options for the Commission. There is the pure suspension. There will be suggestions in connection with a pure suspension as the reason for the Commission's suspension. If, thereafter, carriers chose to read that opinion and come in with further

filings seeking special leave, there is obviously no prohibition on them doing so, no guarantee that it would be accepted.

What we are really saying is that the positions that are contended for by the Protestants are a blatant, flat out attempt to have the Commission go around its lack of power to prescribe rates without full hearing and do exactly that, i.e., effectively prescribe a rate without the required hearing. I think that is the gist of the argument.

Commissioner Murphy: If the Commission, though, takes the information that you have furnished and this is not one under oath, I grant you it is not a formal hearing, but you, as well as the rest, are supposed to give us the actual facts to the best of your ability and that's what we have to go on.

Now, the Commission has to explain why it takes any action whether to suspend or deny. We have to give you some reason for it. What would be wrong if the Commission found that, based on this rate, as informal as it may be, that the information and data that you have supported doesn't justify the charges that you have published, but it does justify rates that do not -- that may equal, or be less than the level given?

Mr. Jordan: I would say this. I don't believe that there would be adequate support in the record for such a determination by the Commission. We have furnished a certain amount of information. All of that information, in terms of weight in the record, is directly contrary to such a finding by the Commission.

With respect to verified statements, the only thing that borders on that is Dr. Ileo's statement, which was an attachment to the Alaska protest.

Now, there is the Lendsner piece. But it's already been said here today that no one's contending that that's an appropriate basis for any decision today or that any judgments ought to be drawn by the Commission from it.

So I would say, where's the record? Where are the facts that would justify that? We've got assertions. We've got arguments of counsel. But courts have often recognized that there's a great deal of difference between assertions and arguments of counsel and facts.

I don't think the facts are there. That's going to be our position.

I'd like to move on, if I may, to talk about what is really the key point here, I think, of all today, and that is the 8 percent return approach and what is really involved there.

I thought Mr. Cleary did a very good job of hiding the ball with respect to what the true issue was on the 8 percent.

It is our position that it is the established methodology of the ICC, long-indulged in by the pipeline companies of this country, to apply an 8 percent -- or in consent decree cases, in effect, a 7 percent return on valuation -- and, in so doing, to treat interest on debt as an expense, i.e., above the line, as the saying goes, as distinguished from being below the line.

Now, I would have to concede to the Commission that I cannot point to a single Commission decision which says in nice, stark, black-letter terms, that is the rule of this Commission.

But I would also say to the Commission, that nobody on this side of the rostrum has been able to point to a single Commission decision with nice black-letter law saying interest goes below the line.

In the Williams Brothers' Case, no contest there on the interest issue. It's shown below the line. But that wasn't the point in the Williams Brothers' Case and it was not addressed. So that's not a decision on the merits with respect to interest.

The earlier cases, nobody was really addressing that point. It wasn't an issue in those days. That's not what everybody was looking at.

Now, a practice has developed. As we pointed out in the ARCO presentation, Chairman Stafford went down before the Congress and explained to the Congress the relationship between

the consent decree and the 8 percent limitation allowed under the ICC procedure.

Now, his point down there was, that the consent decree is acting as a limitation, basically, on the earnings of pipeline companies, because they are basically not allowing themselves to earn more than they can pass back as dividends under the consent decree.

The simple fact of the matter is that that could not have been true if there were a difference in the treatment of interest as between the ICC methodology and the consent decree methodology for any pipeline that had a highly leveraged capital structure.

And Exxon has set forth in its papers a formula that will let you sit down and figure out just how that works. We have also made reference to--and I haven't heard anybody here lay a glove on it today -- what we've referred to as the home-gate data. That was a submission by Chairman Stafford. It was really two submissions.

Somebody, I think Mr. Cleary, joking, said, well, I had go back and correct it.

Well, I think that's significant. They submitted one in November and then, I think, the ensuing March, they submitted another one.

The point is, that somebody went back over those numbers, checked every one of them, and then resubmitted the data to

the Congress, as an official expression of the Commission on what the rate of return on valuation was.

We had Mr. Jeter of Arthur Anderson pull the Form P from the Commission's own records, do all of the calculations for all of those companies, and with the exception of, I think, three, where he couldn't find the Form P -- for the selection you picked was a lot more than the companies represented here today. In every case, it showed that rate of return on valuation was calculated assuming interest as an expense.

That's not a decision of the Commission and I recognize that distinction. But I think it's the best possible evidence as to what the practice of the Commission has been.

Now, let me say something about this development of --

Commissioner O'Neal: Let me ask you, just to get this on the record. You are talking -- do you agree with the characterization of what you are seeking in terms of return on valuation that -- I think BIE said that you seeking 12.5 percent, in effect, on valuation?

Mr. Jordan: Well, we're seeking 7 percent on valuation, as we have always understood the whole concept of rate of return on valuation.

If you take away interest as an expense --

Commissioner O'Neal: You are seeking 7 percent on the total valuation plus interest?

Mr. Jordan: Well, we're seeking 7 percent return on valuation

and before we calculate what that return is -- what the net income figure is -- we have taken out interest as an expense element. Just along with operating expenses and other forms of expenses, we have taken interest on debt.

We tune that to the 7 percent figure in the consent decree and that is our understanding of the methodology.

And it seems to us that what we're being told here today is that they would like to take away the historically recognized, we think, interest deduction, but hold tight on everything else, basically. Except the Bureau would say, well, we'll up it to 10 percent. Now, that in itself represents a deviation in Commission practice for crude lines. This is a crude line. The old cases established 8 percent for crude, 10 percent for product.

Commissioner O'Neal: I think you are, in effect, seeking or proposing a debt equity ratio so that you get 100 percent equity. That's what you're talking about. And I assume you're saying that because the parent companies have guaranteed the --

Mr. Jordan: We're not seeking anything based on 100 percent equity. What we're saying is that we believe the Commission methodology involves coming up with a valuation under Section 19(a) and there are elaborate procedures for doing that, for having a tentative valuation and having it challenged.

We think we're entitled to this rate of return on that valuation, in accordance with traditional practice.

Now, what the Protestants are saying is, let's take away the interest. It's always been deducted and always been allowed. But on the other hand, let's not let the rate of return go up to any sort of fair level.

Now, talk about double-dipping. That's double-dipping with a vengeance. In other words, you're taking away something that everyone has historically relied on and saying, hold tight there after you've taken that away. Don't change anything else except for the 10 percent concession.

We don't think that's fair. It's not the basis on which this investment was made. It's a contradiction of prior Commission practice and as we point out, we don't think it ought to be done in this proceeding.

If that kind of decision is going to made by the Commission, it can be made by the Commission, so long as it ends up at a fair rate of return overall. But 308, we think, is the place to do that.

As far as the capital structure point is concerned, the point there was -- we're not contending for any change in the method of calculating rate of return. I tried to make that clear this morning.

But we were offended by these very, very high rate of return figures which continue to be thrown around. And we

offered this point about capital structure just to put this whole issue in perspective, to say that, you can't look at it that way.

Mr. Cleary made an offer of the testimony of Dr. Ileo, which he said was available. I,too, would encourage everyone to read that. I think when you read everything that Dr. Ileo says about Makisky and TeSoro and the relationship between them, you will not be able to draw any distinctions, as a practical matter, between that and the relationship between the parent companies here and their subsidiaries. With 100 percent of the debt guaranteed, it really doesn't make much difference whether you lend them the money directly or you have a fusion of capital or what you do. The guarantee of the debt is the equivalent of all of those other techniques. And there simply is no distinction and no explanation has been made that would distinguish the views of our experts or say in any significant way that Dr. Ileo's view is not consistent with those of the people that were cited.

Let me make one [illegible] point with respect to this development of oil situation. A lot has been said about delay in the development of oil. A couple of points.

First of all, we are unaware that there are any prospective sales of additional leases on the books by the State of Alaska. Until that takes place, there won't be any significant further development of oil. There will obviously be further work with

respect to established fields.

This is basically a timing question. It seems to us on this, as on many other points, the real course of action, the fair course of action, I think, to really resolve all of these conflicting interests that have bubbled up here today, would be for the Commission to resolve to proceed as rapidly and as expeditiously as possible to resolve this whole matter.

In other words, have a proper hearing. Determine what the lawful rate is. Everybody will know where they stand. And this problem of delay that affects the Arctic Slope Corporation will be greatly diminished if the Commission would move ahead rapidly with this.

This argument about delay in the development of the oil will similarly fall to one side.

Oil development is a longterm thing. It's not something that is going to take place in seven months, the maximum period of suspension allowed by the Act.

So there is a way. There is a way to handle this properly and that way is to move ahead on valuation and move ahead on investigation. No one has really objected to the concept of investigation. I think we all recognize that there is going to be an investigation unless we are very much surprised.

Move ahead on 308. We still think that 308 has moved along fairly well and has the promise of resolving many of

these knotty, sort of methodological questions. And the best thing to do is to keep 308 moving so that the input from that can become effective with respect, no only to this pipeline, but to all other pipelines.

So we think that's really the only fair way to do it.

Now, there was one point made with respect to the windfall question, the question of the increased throughput. I trust the Commission understands that the tariffs that have been computed -- I think it's clear in the supporting justifications -- have been computed on the basis of averaging over a certain limited period of time, as is traditional, based on certain assumptions about throughput, including increased throughput.

Now, if you will look at the various papers, you'll find that different companies have different assumptions about throughput. Some people think it's going to one level in 1980 and some people think it's going to another level in 1980. The point is, the tariffs were set on the basis of those assumptions.

They are not set for all time. They are not tariffs which were intended to apply, on the whole, when those assumptions which are no longer valid and when there is an expansion beyond the kind of expansion that is set forth in those assumptions.

So, the process of windfall is really misleading. If you want to talk about reverse windfall, the companies could have pegged their initial tariffs to a 600,000-barrel-a-day rate rather than the 1.2-million-barrel-a-day rate. At that point, I can't even think what the tariffs would be but we'd probably be talking about a $9.50 or a $10 tariff.

What has been done here, in order to make the tariffs more reasonable, is to utilize an averaging period and that averaging period typically includes increased throughput even beyond the 1.2 million barrels a day and that includes the need for further capital expansion. So, don't be misled by this sort of windfall argument. That is just not so; it's not the way it would work; it's not the way the tariff structure was set up.

Commissioner O'Neal: How long would you be pumping at a 600,000-barrel rate?

Mr. Jordan: Well, people have different views about that. In the ARCO submission, we projected that we would be pumping at that rate for September and October. Other submissions have different --

Commissioner O'Neal: For September and October?

Mr. Jordan: September and October and we would go to the 1.2 rate around the 1st of November. Some of the other carriers' submissions have slightly later assumptions with reaching the 1.2. I think it can be generally said, with a fair degree of certainty, that everybody is thinking about calendar 1978 as basically a 1.2 million-barrel-a-day year.

That's a fairly sound assumption, but we're talking about a pipeline that's just getting started up and there's a lot of uncertainty about just when we will reach particular rates.

We appreciate the opportunity to submit our views to the

Commission. These are difficult questions. We believe that the approach which we have suggested is a fair and reasonable one and we are convinced that the carriers, regardless of the quibbles about methodology and efforts, decimal points, debt equity ratios, are not, in any case, seeking a return which is unfair or unreasonable.

We are also convinced that we have, to the very best of our ability, tried to comply with established ICC methodology. We would trust that the Commission would allow these tariffs to go into effect, that it would initiate prompt proceedings, as necessary, on the investigation front with respect to rates, on the valuation front with respect to the valuation and in terms of the 308 proceeding, to bring all these thorny problems to a prompt conclusion.

Commissioner O'Neal: Thank you.

Mr. Cleary, for 15 minutes of re-rebuttal.

Mr. Cleary: I averted, I think, before to the parent subsidiary relationship. But since the carriers are continuing to ask that the standard be deviated from, at least to get away from the 8 percent to the value of the standard because capitalization of the companies requires more of the individual companies, and then they want to hide the high return de facto earned on the equity to the pipeline, by saying, "Well, that's not really right, that's a phoney number"; the fact is, it's dollars related to the equity investment. They want to avoid that, then, by leaping to the parent companies. They're jumping again the standards.

I go back to the 1940 case, the first case the Commission ever had to reduce pipeline rates and gathering charges case. And at page -- well, I've got a little problem here reading what page it is -- about three pages from the end, second page right before the tables.

The Commission was posed with this same thing, about penetrating through to the parent companies. They said this -- and I indulge here with a rather lengthy quote, but I think it's very important -- "In the determination of the question whether the rates and charges of these common carrier Respondents are lawful, we cannot attach any controling weight to the fact that the Respondents or their beneficial owners have seen fit to pay charges from the one pocket to the other, or

to operate their common carrier and industrial properties in such manner that the carrier system is virtually a plant facility of the larger producing, manufacturing and selling industry.

"These facts, if they be facts, are immaterial in this proceeding. More than mere bookkeeping is involved. The measure of a reasonable rate for a common carrier cannot be made to depend upon such consideration.

"Whatever the relations between the pipelines and the oil companies which beneficially own them, Congress requires all rates tendered to the public by these common carriers to be just and reasonable and no more.

"Every carrier subject to the Act must maintain a schedule of just and reasonable charges, regardless of whether the public generally has been or is in a position immediately to avail itself of the service.

"As will be seen hereinafter, the general measure of the rates of many important respondents is accepted. And it is no answer to such a finding that independent shippers are few, or that they are not using the service offered, when the rates demanded are excessive."

Now, the Commission said that in 1940. It's the same case where they said 8 percent on valuation is the standard. And you repeated that consistency and fairness will not permit you to deviate from it. You said it in December, as I indicated.

And they have talked about Mr. Jeter checking out the computations, and what the source was. I think the investigation really might penetrate as to who prepared those numbers, and what did they have in mind? Why didn't they put a footnote when they're telling Mr. Hungate or someone else on the Hill what the numbers mean?

And I'm very serious when I say the end report to Congress of this Commission has reported dollars invested in TAPS as carrier property, and measured returns of pipelines to tell the Congress how profitable pipelines are. Yet, it's got $3 billion or so, as of the end of 1976 -- already had been invested up there, and it might have been as much almost at the end of '75.

In Ex Parte 308, Williams Pipeline hired Mr. Robert R. Nathan to put some figures in. And he wanted to compare Williams with the average pipeline. He said, "My gosh, you could not do this, because the apparent return, according to Commission statistics and transport statistics, which are then used in the report to Congress, show a decline in the profitability in the last three years.

It hasn't occurred, except because of the inclusion of the investment in Alaska. Not one penny of revenue has been flowing, yet the numbers have. This Mr. Nathan saw this was misleading, and he threw those numbers out. Unfortunately, the Bureau witness that was submitted from the Commission in the proceeding didn't do that, didn't throw the numbers out, and

there is some problem.

We have worked our way through that in Ex Parte 308. Hopefully, it will be an on-the-record proceeding. I don't think it is, according to what the Judge has said, and what has been affirmed by Commission order.

And I don't see how these people think they're going to get the protection they think they're entitled to. I think it should be an on-the-record proceeding, but it isn't now. All right.

Mr. Jeter could have been well hired to go back to the underlying accounts and reports of these carriers that the Commission used in its 1940 report. Or, he could have gone to the figures for 1947, '48, that were in the subsequent report, in the same reduced pipeline gathering rate case.

I think he would have found, yes, some of these pipelines were incurring debts. Where did they record it, above the line or below the line? Anyone who looks at an annual report of the ICC interests is below the line. Where was it used in the Commission's decision? It wasn't in there at all; it was below the line.

In computing the return of 8 percent on valuation, the Commission has always used this. The only thing they have got -- I guess what they're referring to is the unreported Administrative Law Judge decision, the one that Mr. Schwartz participated in.

One can go to the heading of that one. It's a Griffith, Indiana case, I guess it is. There was an Administrative Law Judge decision. Well, the first page of it shows there's no opposition in the case. He was appearing for Lakehead Pipeline.

It's very interesting to see the intricate relationship between Lakehead and Interprovincial. The Canadian Energy Board has had the same problem this Commission faces, looking at -- the same way as in 308 -- what is reasonable rates?

They did not defer and say, "We'll go to some other case we will have in a 308 type proceeding". They said, "No, we will look at it". They found, "We'll deviate; we're going to change this idea of a valuation base."

They're not using it in Canada now. They've gotten away from it. Because they've found, if you start inflating the base, how do you get a comparable earning? Because comparable earnings in the economy don't have insurance against inflation that comes from an inflated rate base.

So, you've got to take assumptions upon assumptions. It's just not workable.

The fact is that case after case by this Commission has not included interests above the line. The only one they talk about is -- I guess they're referring to petroleum crude oil at Griffith, Indiana to New York State points, Docket 352. Mr. Schwartz entered an appearance.

Ashland Oil Company had been a Protestant and they didn't appear. I think they had some pipelines. There was an appendix -- I don't know what the source of it is, I haven't read the record in that case but, admittedly, there is a little table there that computes and has some interest above the line, the only example.

And that decision -- of course, there were no exceptions, obviously, to the Administrative Law Judge decision. It became the order of this Commission, as a matter of law, apparently sometime close to the end of the year. I guess you could say, since the service date on the decision was October 14, it would have been before the Williams case was decided and, therefore, the Williams case would clearly overrule it, if it was in the -- in the recognition of anyone deciding the cases.

Judge Nacy had this question but, specifically, as I indicated on the seven percent, and he found flat out you do not deduct the interest before computing an ICC return even though the carriers have been arguing that in the Key 9 case --he said the decision in that case--and he was referring

to the Williams case, "The decision in that case is presently being appealed." This was between the division decision and the entire Commission.

"I conclude that interest should not be included as an expense item for the purpose of the present proceeding. However, the rate of return is expected to cover serving of debt." That case also became a Commission decision. It was affirmed by Division 2, Commissioners Hardin, O'Neal and Christian, an order served by October 21, 1976.

The only thing they've got is a couple of letters and a few mistakes I think that were in Commission decisions up to Congress -- or, letters up to Congress. Now, what about this eight percent standard? We think it is a standard. They know what it is.

I think an order that says you haven't followed that standard -- I don't even think the Commission has to say that now, just suspend. It's obvious they haven't voluntarily complied with that and it's about time they did. They have come in here and said we recomputed, if we add the interest back in and see what the effective rate of return would be. We have it for three companies, only three of them; Exxon, 12.25 -- these are the numbers given today, they appeared in their pleadings -- Exxon, 12.25; Amerada Hess, 14.9; Sohio, 12.9; all of them substantially above the eight percent standard.

Apparently they should have hired their accountant to make the computation and tell them the difference between 8 and 12; 8 and 14. And I suggest they can figure it out. They can come back with a tariff that will not give them anymore.

The tax flowthrough is extremely important. It's not as important right off the bat but it is important because it is cost-free capital. And the Exxon filings of the SEC -- and the same thing, I'm sure, must be true with respect to the others -- show significant available capital to them at no cost.

Now, that must be taken into consideration if you impute taxes and the FPC has done that. None of them have talked about that. They know that's the rule.

The question of refunds; I think it is clear, from what's been presented to you here today. I couldn't say it half as eloquently as Mr. Gale Lewis did, about the natives in Alaska. Obviously, the State of Alaska has funds that are being planned to come to them through reasonable rates.

The natives of Alaska will not have the schools and all the other resources that they are supposed to have. All this will be deferred. That's the irreparable injury. Whenever the Interstate Commerce Act is violated and it's clearly unlawful, there should be a suspension regardless of who shows the irreparable injury, as I indicated before.

The refund provision, we hear them telling us that all of their experts tell us their cost of capital is 13-14 percent. Now, that's not on this record, but they -- you see, they want to bring that part of the nonrecord in here and have you change your mind.

How do they want us to provide dollars and get back eight percent? We provide them dollars which make available to them capital for the intervening period which they say is worth 12 and 13 -- that's what they would have to pay for it, go out and buy it at 13 and 14 percent. They'll get it from us. Yes, we'll give you back 8 percent. That's irreparable damage.

I think if there is even a concept ever at this Commission, that any reparation is less than the cost of capital to the company that is paying the reparation, it is a questionable constitutional taking without due process. The ratio has never been raised but it should be.

Thank God the Commission at least did say you will follow in all proceedings the 90-day treasury. That makes it a little bit better but it's not adequate. It is still irreparable damage.

Moss, Moss versus CAB is a rather unique case, to say the least. There was a specific formula presented by an airline. There were tariffs that were rejected. The Commission then prescribed other rates and Congressman Moss

thought that what they were prescribing was the result of a specific formula offered by one of the airlines. And as I understand it, that's just about what happened. It's a unique case.

To take that case and say it undercuts the Commission's power to say"Read our 1940 decision and read all of the subsequent ones and come back with a tariff that doesn't give you more than 8 percent return on valuation or, if you feel compelled to go to something else, I think it would be wrong. I do not understand why the Bureau even went to 10 percent because the fact is the 8 percent will pay the interest cost of each and every one of these pipelines.

They may say something to the contrary but the numbers don't add up. They have their interest cost they reported to you, 8 percent on the valuation mainly because, as I said, the valuation was more than the original cost and a lot more than their debt. 8 percent is enough to pay the interest for every one of them and give them some flow into equity and our $3.87 rate that would flow contemplates taxes with respect to each.

Don't deviate from priorities. They say it. I say the same thing. It is a deviation when you go from 8 to 10. 8 percent on value would be no deviation. They would have no argument, in my opinion. The law is clear. We know they are taking it to court.

No matter what this Commission writes, they are going to try and find something that they don't like about it, if the Commission doesn't give them every single penny they have published.

Ex Parte 308, I reiterate, is a questionable relief. It is a questionable proceeding. You are asking that a rule-making proceeding, where there are not rights of the adjudicatory proceeding nature in normal cases be used to decide these very important issues, a fact I presented in Williams. And, unfortunately, 308 has gone forward not very fast.

Thank you.

Commissioner O'Neal: Thank you. Mr. Kaplan, you have five minutes for your rebuttal.

Mr. Kaplan: Mr. Chairman, Members of the Commission, let me just open by discussing the fact that we did file a brief here today, and I move for you to consider that brief.

Unfortunately, it would not have been possible to submit that pleading in any time to the arguments prior to seeing the arguments raised by Respondents. It is a traditional role

in most courts in briefing an issue that a reply to the response is permitted. Arguments were raised here for the first time, very serious arguments, ones which we think serious that they should make the challenge. We don't think that they should be given serious consideration.

You have heard a challenge to your very jurisdiction, the issue of rate prescription. We, also, were very upset about what we feel are material and factual errors and omissions. I will discuss those in a moment.

And also we got some information about how these carriers calculated their rates, for the first time, which we did not have before. So, we addressed only those issues which we did not have an opportunity to address before. And we think, under Rule 2 of the Commission's Rules, calling for a liberal construction, that the Commission should consider it on this very important issue.

On the prescription issue, I think it is very important, and I might clarify the point I made earlier. If the Commission seeks to suspend these rates, that the order not exceed or not even bring the suspension -- the prescription issue into question which I do not think it has to.

I think all you have to do -- all the Commission has to do is suspend the rate subject to refiling tariffs not exceeding lawful limits. And that's all you have to say. I would then go on and discuss the possible lawful limits and,

I think, under any interpretation of lawful limits, as the Protestants have made, that these rates could not exceed rates which would be within $2, now, of what was charged. But I think discussing the applicable limits,the standards in the early pipeline cases,the Williams Brothers,that I believe that these carriers could then, themselves, figure out what should be a lawful rate. And if the Commission decides to suspend the rates to be filed, with a reasonable concise, but clear, discussion of what the law is, they can determine what the rate should be.

And those new rates, of course, would be, I imagine, subject to the same challenge if, in fact, the carriers once again try to get excessive returns.

And of course, the Moss -- the rates set in the Moss Case, were set right in that proceeding. We are not asking you to do that. You have some law on rate of return. Rely on it. It is enough to suspend these rates.

Now, as far as the risk to the non-owner shippers, such as Union, Congress took care of that, as I discussed earlier. I just wanted to cite to the Commission the course the commodities clause covering rail shippers, 49 U.S.C. Section 1, Paragraph 8. Most rail shippers cannot ship goods they manufacture, if it is an integrated company, and I suppose they would be in the position of Union, which has now oil apparently to ship. I wish them luck in finding some oil to

ship, but so long as they don't have any, they are just like a rail carrier.

Congress determined that the suspension power should nonetheless apply. Limit it it to seven months. But Congress made that determination. I don't think that we need be concerned with that possibility.

The challenge to the rates filed by the Commission -- to the Commission's power to suspend rates fails to cite a number of cases which we did in our reply brief, in which there is no question that initial rates were suspended and there was no underlying rate, or no changed rate, or no prior service that was not covered. The machinery from Salt Lake City Case, 304 ICC 286, cited at page 9 in our brief, that was newly acquired operating authority.

In Clay, from Grayville, Wyoming, 314 ICC 705, also on page 9, not only were the rates suspended one time, they were suspended four times. The carrier never offered that service before.

Also, Warren, from Canada and New York to Florida, it was newly acquired operating authority to ship wine to Tampa, Florida, and that service had never been offered.

Commissioner O'Neal: Mr. Kaplan, thank you, your time has expired. Mr. B[illegible]c you have five minutes on your rebuttal.

Mr. Lewis: I will very briefly respond to the ARCO rebuttal. They, once again, don't understand the natives' interest or perhaps that the natives really have any interest.

The concern of the Alaska natives in this proceeding is based directly upon the present value of the wellhead. Any deferral in wellhead value, awaiting the outcome of lengthy proceedings in this case, is going to defer forever in a way that will never be recovered, the only value that the Arctic Slope Eskimos and the other Alaska natives got from the Settlement Act that gave these oil companies Prudhoe Bay. The only value in the Arctic Slope's 5 million acres is that someone is prepared to come in right now and pay money to the Arctic Slope Eskimos for the right to explore and lease and develop their oil reserves.

They are not going to get that money until the tariff issue is settled in a way that ensures an adequate return at the wellhead. They are not going to get jobs until there is someone there hiring them in order to go out on the tundra and develop those reserves. That's not going to happen until the price at the wellhead goes up. And that's not going to happen for a number of years, it's quite obvious, if these proceedings are continued and no rate adjustment is made until the conclusion of those proceedings.

The incredible impact on the State of Alaska's budget will be felt immediately and irreparably by Alaska natives.

The schools and the restoration of the fisheries, which the State of Alaska is legally obligated to pay for and provide to Alaska natives, will obviously not happen if Alaska is waiting for some time in the future for a refund.

These basic, fundamental things, these basic, fundamental fairnesses, will not be dealt with, as long as these unlawful rates are in effect, even though the money might be paid over some years in the future.

Arctic Slope Eskimos appeal to the equity of this body as well as to its common sense. And I'll let you run through a couple of those items. These don't require evidentiary hearings. The TAPS companies are asking this Commission to allow them to amortize replacement cost of their construction at a rate of 6 percent a year for 25 years. They are also asking simultaneously that the Commission allow them to amortize removal costs in 25 years. So it is quite obvious that it won't be simultaneously replaced and removed in 25 years. That does not require an evidentiary hearing.

Secondly, the carriers are asking that interest be treated as a deductible. Then they are asking for a return on that same interest. They ask the Commission to ignore the Williams Brothers -- the Williams Case -- because in that case, the pipeline company merely automatically treated interest the way it ought to be treated. Because it was automatically treated that way, by the pipeline company, the TAPS carriers

say, you shouldn't pay any attention to it.

Rather, they suggest that you should rely on other, many other rates, which weren't even contested, obviously because the carrier and the shipper were the same person and had agreed in advance as to what the tariff would be and that's why it was not protested.

Now, they also argue that in computing debt equity ratio that the Commission ought to look to the debt equity ratio of the parent. But, they don't permit -- they ask the Commission not to take into account, the tax benefits derived by the parent from the subsidiaries, the tax benefits of a subsidiary -- and they also ask the Commission not to take into account the parents' cost of capital, but merely the parents' cost equity, debt equity ratio.

Now, throughput act of 1968, counsel very carefully avoided any comment on what he or his clients believe the throughput would be one year from now, after one year from now. It's obviously going to be more than 1.2.

The Commission does not live in a vacuum. You read the papers. You know what's going on. You've had other submissions. The submissions that have been presented as part of this record, from the carriers on, SEC submissions, and all of the other make it quite obvious that throughput is not going to be 1.2 million more than a year from now.

Lastly, the field life, there is information before the

Congress. It's been submitted to the Department of Interior, the energy departments, to the President. It has been repeated time and time again by executives of various oil companies, about the additional potential of oil on the Arctic Slope, and they always talk in terms of 30 to 40 to 50 billion additional barrels.

Commissioner O'Neal: Thank you, Mr. Lewis.

Mr. Greenberg, you have ten minutes on re-rebuttal.

Mr. Greenberg: Thank you. I guess the first thing to say here is, it's about time somebody defended Commissioner Stafford with regard to the response that has been submitted to the Hungate Committee. That is why we included as an exhibit, in the attachments we gave you, Exhibit 8, the two-page, I guess, answer, submitted by Commissioner Stafford, then chairman.

I direct your attention to page 2 of that exhibit, in which Commissioner Stafford points out specifically that in Schedule A,interest expense is not deducted from that income; in Schedule B, interest expense is deducted from that income.

It is clear that the Commission, in sending these figures to the Hungate Committee, was only giving an alternative basis upon which the various figures could be computed. It was making no representations as to the authenticity or how they will be used in ratemaking standards.

What we see here is that ARCO and Exxon, in their appendices, have attached this much material (indicating) -- excuse me, I have a pack of -- it's this much material (indicating) on how the various items could be computed.

What they don't give you is this much material (indicating), which was also in your submission terms, in which it is clear that what we're talkir about was alternative methods of computing rates of return, whether with or without interest.

And we've tried to make it very clear that there is ample

precedent in every contested case that has been before this Commission that interest has been treated as part of the return on valuation.

In our protest, on pages 28 and 29, we have run the figures from the reduced rates and pipeline gathering charges case. In the Menulusa case, we've run the figures. In the Williams Brothers case, which we have reread and properly stated in our brief that it did not cancel the proposition. Happily, it does cancel the proposition.

It is clear, every single contested case treats interest exactly the same way, we're suggesting it ought to be treated here today.

One additional distinction that should be made, perhaps, as to the Moss case, aside from the fact that it clearly is not a prescription case, is that the D. C. circuit was most unhappy about the way the CAB was dealing with the offering by the airlines. It was an ex parte proceeding.

No one except the airlines and the CAB commissioners was present at that meeting. In fact, they had the audacity to exclude Congressman Moss from those deliberations. I suggest that this was of some concern to the circuit.

If you are asking the Commission to prescribe a rate in this proceeding, we wouldn't ask them to accept the figures that they have presented here today. We would ask them to disregard this nonsense about 25 year service life, for

depreciation purposes or for removal and restoration costs. We would ask them to disregard the normalized tax treatment which they have accorded themselves.

We would also ask to the Commission to disregard all the known costs as of this date, which are attributable to inefficient management, such as the reweld problems which have been well publicized in the Sag River difficulties. But we're not asking for that.

We're asking to take their figures, which they have put before you, and use your classical method of rate of return valuation and come in with an appropriate rate. That's all we're asking for.

Thank you.

Commissioner O'Neal: Questions?

(No response.)

Thank you. Thank all of you for participating in this oral argument. This concludes the oral argument. We are adjourned.

(Whereupon, at 3:59 p.m., the proceedings were concluded.)

Exhibits In Aid of Oral Argument Submitted By ICC Bureau of Investigations And Enforcement, June 27, 1977

[Caption Omitted in Printing.]

I N D E X

	Exhibit
Recoverable Oil and Gas Resources in Alaska	1
Basic Issue for Decision	2
Proposed Rates Produce an Excessive Return of at Least 49% on Average Equity Investment	3
Proposed Rates Will Allow Excessive Returns	4
Exxon Pipeline Company's TAPS Tariff Computation	5
Sohio Pipe Line Company Projected Return on Equity	6
Extract from No. 35533, Petroleum Products, Williams Brothers Pipe Line Company, Decided December 3, 1976	7
Response of Chairman Stafford of November 10, 1975, to the Questionnaire Submitted by Congressman Hungate	8
Resulting Rates of the Trans-Alaska Pipeline System Based on Operating Expenses, Depreciation, Interest, and Removal and Restoration Costs Reported by the Carriers	9

EXHIBIT 1

RECOVERABLE OIL AND GAS RESOURCES IN ALASKA

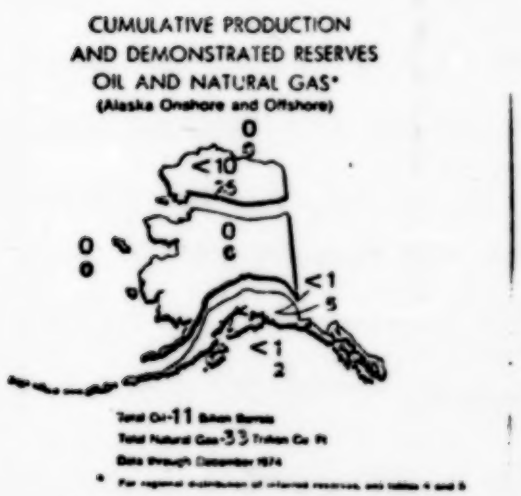


FIGURE 10.—Cumulative production and demonstrated reserves of oil and natural gas by regions for Alaska, onshore and offshore to 200 metres.

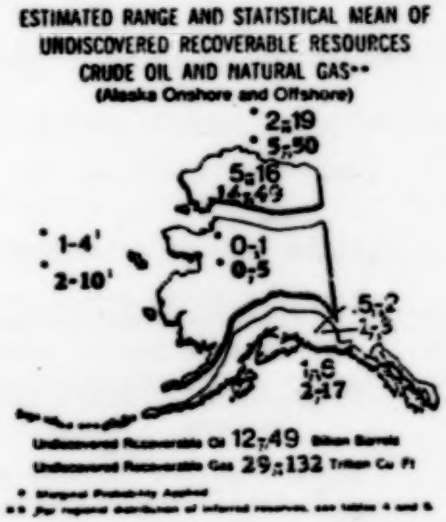


FIGURE 11.—Undiscovered recoverable resources of crude oil and natural gas for Alaska onshore and offshore to 200 metres. (Ranges of values were derived by Monte Carlo methods from estimates made by the Resource Appraisal Group and reported at 95-5 percent probability levels in billions of barrels for oil and trillions of cubic feet for gas.)

[1] Estimates reported at the 75 and 25 percent probability levels because, in these areas, these levels are judged to be more applicable for some planning purposes. It must also be noted that in frontier areas, lacking discovered indigenous or adjacent recoverable hydrocarbons, uncertainty is sufficiently great as to weaken greatly the estimates at extreme ranges. For purposes of comparison with other recorded ranges, the 95-5 percent probability range in offshore Atlantic is 0-6 billion barrels of oil and 0-22 trillion cubic feet of gas (fig. 11); in the Bering Sea it is 0-8 billion barrels of oil and 0-10 trillion cubic feet of gas (fig. 12).

Note: Oil estimate in boldface, gas estimate in italics.

Source: "Geological Estimates of Undiscovered Recoverable Oil and Gas Resources in the United States," Geological Survey Circular 725, prepared for the Federal Energy Administration by the U.S. Geological Survey, U.S. Department of the Interior, pp. 32-33 (1975).

Exhibits in Aid of Oral Argument of the I.C.C. Bureau of Investigations and Enforcement

EXHIBIT 2

BASIC ISSUE FOR DECISION

SHALL THE COMMISSION ALLOW THE PIPELINE COMPANIES THE OPPORTUNITY TO EARN UP TO 10 PERCENT OF VALUATION ACCORDING TO THE ESTABLISHED FORMULA USED IN PRIOR CASES, NAMELY,

$$\frac{\text{INTEREST} + \text{AFTER TAX RETURN FOR EQUITY}}{\text{VALUATION}} = 10\%$$

OR SHALL THE COMMISSION FOR THE FIRST TIME IN ANY REPORTED CASE ALLOW THE CARRIERS TO EARN AS MUCH AS 7 PERCENT OF VALUATION JUST FOR EQUITY ACCORDING TO A FORMULA IT HAS NEVER APPROVED FOR PIPELINE RATEMAKING PURPOSES, ALTHOUGH USED BY A LAW JUDGE IN ONE ISOLATED CASE, NAMELY,

$$\frac{\text{AFTER TAX RETURN FOR EQUITY}}{\text{VALUATION}} = 7\% \ ?$$

EXHIBIT 3

PROPOSED RATES PRODUCE AN EXCESSIVE RETURN
OF AT LEAST 40% ON AVERAGE EQUITY INVESTMENT

PIPELINE CARRIEPS' PROPOSED FORMULA:

$$\frac{\text{AFTER TAX RETURN FOR EQUITY}}{\text{VALUATION}} = 5.8\%$$

RESULTING TOTAL PROPOSED RETURN FOR EQUITY:

AFTER TAX RETURN FOR EQUITY = 5.8% x VALUATION

AFTER TAX RETURN FOR EQUITY = 5.8% x $9,747 million

AFTER TAX RETURN FOR EQUITY = $ 568.4 million

EQUIVALENT PERCENT RETURN ON EQUITY INVESTMENT:

Since the equity investment in TAPS will be no more than 15% of the total invested capital of $9,295 million, or $1,394 million, the pipeline carriers' total proposed return for equity of $568.4 million equals $568.4 million ÷ $1,394 million, or an average return on equity of 40.7%.

Exhibits in Aid of Oral Argument of the I.C.C. Bureau of Investigations and Enforcement

PROPOSED RATES WILL ALLOW EXCESSIVE RETURNS
IN 1978 AT 438 Million B/ Yr. Throughput
(Million)

(1) Carrier	(2) Implied Return for Equity At Proposed Rates		(3) Interest	(4) Percent Return on Valuation Purported[1]	True[2]	(5) Percent Return on Equity 3
Sohio	(33.34%)	$ 175.0	$ 252.5	5.4	13.2	37.6
Arco	(21.00%)	112.6	140.2	5.5	12.3	38.4
Exxon	(20.00%)	127.5	116.4	6.5	12.5	45.7
BP	(15.84%)	93.4	118.9	6.0	13.8	42.4
Mobil	(5.00%)	30.9	32.7	6.3	13.1	44.1
Union	(1.66%)	10.2	9.6	6.3	12.2	44.3
Phillips	(1.66%)	10.3	10.3	6.4	12.7	44.8
Amerada Hess	(1.50%)	8.5	11.4	5.8	13.6	40.5
TOTAL		$ 568.4	$ 692.0	5.8	12.9	40.7

1) Col. 2 ÷ (Percent ownership X $9.747 billion)
2) (Col. 2 + Col. 3) ÷ (Percent ownership X $9.747 billion)
3) Col. 2 ÷ (Percent ownership X 15% X $9.295 billion) or $1.394 billion.

TRANS-ALASKA PIPELINE SYSTEM
PROPOSED RATES WILL BRING EXCESSIVE RETURNS FOR EQUITY
AS ADJUSTED - YEAR 1978
($ Millions)

	Total 1978 (100%)	Sohio (33.34%)	ARCO (21.00%)	Exxon (20.00%)	BP (15.84%)	Mobil Alaska (5.00%)	Union Alaska (1.66%)	Phillips (1.66%)	Amerada Hess (1.50%)
1 Operating Expenses	$ 409.0	135.2[3]	90.3	80.0	64.7	19.7	6.5	6.3	6.3
2 Depreciation & Amortization[1]	364.9	126.2	77.2	73.7	52.0	18.1	5.8	6.1	5.8
3 Removal and Restoration[2]	42.2	14.0	8.9	8.4	6.7	2.1	.7	.7	.7
4 Reported Interest	692.0	252.5[3]	140.2	116.4	118.9	32.7	9.6	10.3	11.4
5 Grand Total	1,508.1	527.9	316.6	278.5	242.3	72.6	22.6	23.4	24.2
6 Implied Return for Equity Before Taxes at Proposed Rates[4]	1,206.8	371.5	239.1	270.7	198.3	65.6	21.7	21.8	18.1
7 Imputed Income Taxes[5]	638.4	196.5	126.5	143.2	104.9	34.7	11.5	11.5	9.6
8 Implied Return for Equity After Taxes	568.4	175.0	112.6	127.5	93.4	30.9	10.2	10.3	8.5
9 Proposed Rates ($/B)	6.20	6.16	6.04	6.27	6.35	6.31	6.09	6.22	6.44

1 Based on 25 year service life
2 ($1.049 billion ÷ 25 years) X percent ownership
3 As amended by Sohio in its letter of 6/13/77
4 (Line 9 X 438 mill. B/Yr. X percent ownership) - Line 5
5 52.9% X Line 6.

Exhibits in Aid of Oral Argument of the I.C.C. Bureau of Investigations and Enforcement

EXHIBIT 4
Page 2 of 3

EXHIBIT 5

EXXON PIPELINE COMPANY'S T. S TARIFF COMPUTATION

	$\bar{M}$$				
	1978	1979	1980	1981	1978-1981 Average
Revenue	572.0	567.4	563.2	571.5	568.7
Operating Expense					
Alyeska Field and Administrative	44.8	47.0	49.4	57.1	49.6
Topping Plant Fuel and Natural Gas	4.5	4.6	4.7	6.1	5.0
Exxon Pipeline Company Administrative	.7	.7	.8	.8	.8
Ad Valorem Taxes	31.9	31.9	31.9	32.8	32.1
Book Depreciation	73.7	73.7	73.7	75.8	74.2
TAPS Dismantling	16.4	16.4	16.4	16.4	16.4
Interest Expense	114.5	106.7	98.7	92.6	103.2
Taxable Income					267.4
Provision for Income Taxes					149.1
Earnings					138.3
Throughput - $\bar{M}$B	87.60	87.60	87.60	100.22	90.75
ICC valuation					1,976.3
Return on Valuation - %					7.0
Tariff Rate - $/bbl.					6.27
True Return on Valuation					12.2%
Estimated Return on Equity Investment 1/					49.6%

1/ Based on 20% ownership and estimated 15% average equity in $9.295 billion total investment.

Exhibits in Aid of Oral Argument of the I.C.C. Bureau of Investigations and Enforcement

EXHIBITS

SOHIO PIPE LINE COMPANY
PROJECTED RETURN ON EQUITY BASED ON
DATA FURNISHED BY COMPANY
($ MILLIONS)

	1978	1979	1980	1981	1982
1 Cost of Property (1)	$3169.0	3395.4	3395.9	3395.9	3395.9
2 Accumulated Depreciation	167.7	294.5	431.3	568.1	704.9
3 Property, Net	3001.3	3100.9	2964.6	2827.8	2691.0
4 Debt (2)	2714.8	2889.2	2816.3	2675.3	2527.0
5 Owner's Equity	286.5	211.7	148.3	152.5	164.0
6 Return on Equity ($)	$ 175.0	176.5	286.3	293.6	301.2
7 " " " (%)	61.1%	83.4%	193.0%	192.5%	183.6%

1) Capital expenditures plus capitalized overheads and interest estimated by carrier.

2) Based on interest expenses at 9.3 average rate; estimated by carrier.

Exhibits in Aid of Oral Argument of the I.C.C. Bureau of Investigations and Enforcement

SOHIO PIPE LINE COMPANY
PROJECTED RETURN ON EQUITY BASED ON
DATA FURNISHED BY COMPANY
($ MILLIONS)

	1978	1979	1980	1981	1982
1 Shipments (Millions of BBLS)	146.0	146.0	188.6	188.6	188.6
2 Revenue (@ 6.16 per bbl)	$899.4	899.4	1,161.8	1,161.8	1,161.8
3 Operating Expenses	135.2	133.7	141.2	138.9	136.6
4 Depreciation & Amortization	126.2	126.8	136.8	136.8	136.8
5 Removal & Restoration	14.0	14.0	14.0	14.0	14.0
6 Interest	252.5	250.2	261.9	248.8	235.0
7 Total	527.9	524.7	553.9	538.5	522.4
8 Return on Equity Before Income Taxes	371.5	374.7	607.9	623.3	639.4
9 Taxes (line 8 X 52.9%)	196.5	198.2	321.6	329.7	338.2
10 Return on Equity After Taxes	$175.0	176.5	286.3	293.6	301.2

No. 35533

EXHIBIT 7

EXTRACT FROM PETROLEUM PRODUCTS, WILLIAMS BROTHERS PIPE LINE COMPANY, DECIDED DECEMBER 3, 1976

Set forth below is the computation of WBPL's earnings and rate of return on valuation for the years 1970, 1971, 1972, and 1973. This table goes back to 1970 because the complaint brings the reasonableness of WBPL's rates into question as far back as August 20, 1970. It extends through 1973 because the record and the pleadings have concerned themselves with 1973 as well as the earlier years. Since the increased rates here under investigation became effective at about the beginning of 1972, the table encompasses a sufficient time period to show the reasonableness of WBPL's earnings under the increased rates as well as under the previous level.

	1970	1971	1972	1973
Operating revenues[a]	56,963,249	56,952,929	60,523,560	63,309,474
Operating expenses	23,822,092	30,192,321	32,754,442	34,651,281
Interest expense	13,120,000	13,319,456	12,716,228	12,116,884
Income tax[b]	6,552,555	6,451,625	7,225,387	7,939,828
Income after taxes[c]	20,518,602	20,334,863	20,543,711	20,719,365
Valuation[d]	211,143,500	226,706,100	229,389,100	238,195,500
Return on valuation	9.72%	8.96%	8.96%	8.70%

[a]Includes incidental revenues.

[b]Operating revenues, less operating expenses and less interest expense, times statutory rate of 48 percent.

[c]Operating revenues less operating expenses and less income tax.

[d]Final valuation for 1970 and tentative valuations for 1971, 1972, and 1973, from Valuation Docket No. 1423.

As may be seen, WBPL's return on valuation was below the 10-percent level for each of the years in question. Accordingly, we conclude that WBPL's earnings were not excessive for any of these years, and that its overall rate level for these years was just and reasonable.

Exhibits in Aid of Oral Argument of the I.C.C. Bureau of Investigations and Enforcement

RESPONSE OF CHAIRMAN STAFFORD OF NOVEMBER 10, 1975 TO THE QUESTIONNAIRE SUBMITTED BY CONGRESSMAN HUNGATE, CHAIRMAN OF THE SUBCOMMITTEE ON THE ACTIVITIES OF REGULATORY AGENCIES HOUSE COMMITTEE ON SMALL BUSINESS

QUESTION NO. 5

ICC figures on the average return on investment for companies owning oil pipelines for the last five years. Also, any ICC action over the last five years taken on rate regulation of pipelines.

ANSWER:

PART I - Figures on Average Return: In response to the request for average return on investment we are transmitting Schedules I through V and Schedules A through G.

Schedule I is a four-year summary of the average rate of return on carrier's valuation as determined by the Interstate Commerce Commission. The summary information in this Schedule is from Schedules II through V.

Schedules II through V show, by years, each carrier's valuation, net income and rate of return on valuation. Carrier valuations are from reports issued by the Commission on each individual carrier. Net income is from Annual Report Form P submitted yearly by each carrier.

Schedules A and B are five-year summaries of rate of return on net investment. The summary information in these schedules is from Schedules C through G and reflect the rates of return on net investment, giving effect to interest payments on long-term debt. In Schedule A interest expense is not deducted from net income. In Schedule B interest expense is deducted from net income.

Schedules C through G show, by years, net investment in carrier property (investment less accrued depreciation and amortization), net operating income less Federal income tax (statutory rate), net income (operating income less interest expense and Federal income tax) and rates of return on these two net incomes. All information in these schedules, except Federal income tax which was computed at a statutory rate of 48 percent, was taken from the Annual Report Form P submitted yearly by each carrier.

RESULTING RATES OF THE TRANS- ALSKA PIPELINE SYSTEM
BASED ON OPERATING EXPENSES, DEPRECIATION, INTEREST, AND REMOVAL AND RESTORATION COSTS
REPORTED BY THE CARRIERS TO THE BUREAU OF ACCOUNTS FOR THE YEAR 1978
AND AN OVERALL 10% RETURN ON VALUATION
($ millions)

	Total 1978	Sohio	ARCO	Exxon	BP	Mobil Alaska	Union Alaska	Phillips	Amerada Hess
1. Operating Expenses	$ 409.0	135.2	90.3	80.0	64.7	19.7	6.5	6.3	6.3
2. Depreciation[1]	364.9	126.2	77.2	73.7	52.0	18.1	5.8	6.1	5.8
3. Removal & Restoration[2]	41.9	14.0	8.8	8.4	6.6	2.1	0.7	0.7	0.6
4. Interest	692.0	252.5	140.2	116.4	118.9	32.7	9.6	10.3	11.4
5. Sub-total	1,507.8	527.9	316.5	278.5	242.2	72.6	22.6	23.3	24.2
6. Return for Equity[3]	282.7	72.5	64.5	78.5	35.5	16.0	6.6	5.9	3.2
7. Imputed Income Taxes[4]	317.5	81.4	72.4	88.2	39.8	18.1	7.4	6.6	3.6
8. Grand Total	$2,108.0	681.8	453.4	445.2	317.5	106.7	36.6	35.8	31.0
9. Resulting Rates[5] $ Per Barrel	4.81	4.67	4.93	5.08	4.58	4.87	5.03	4.92	4.71

1/ Based on a 25-year service life and varying assumptions on total investment.

2/ Removal and restoration costs of ARCO, Exxon, BP, and Mobil are adjusted to pro rata share of the alleged $1,049 million one-time cost over 25 years, consistent with the treatment of this expense by the other carriers.

3/ (Percent ownership x 10% x $9.747 billion) - Line 4.

4/ Percent ownership x [(Line 6 ÷ 47.1%) - Line 6].

5/ Line 8 ÷ 438 million B/yr.

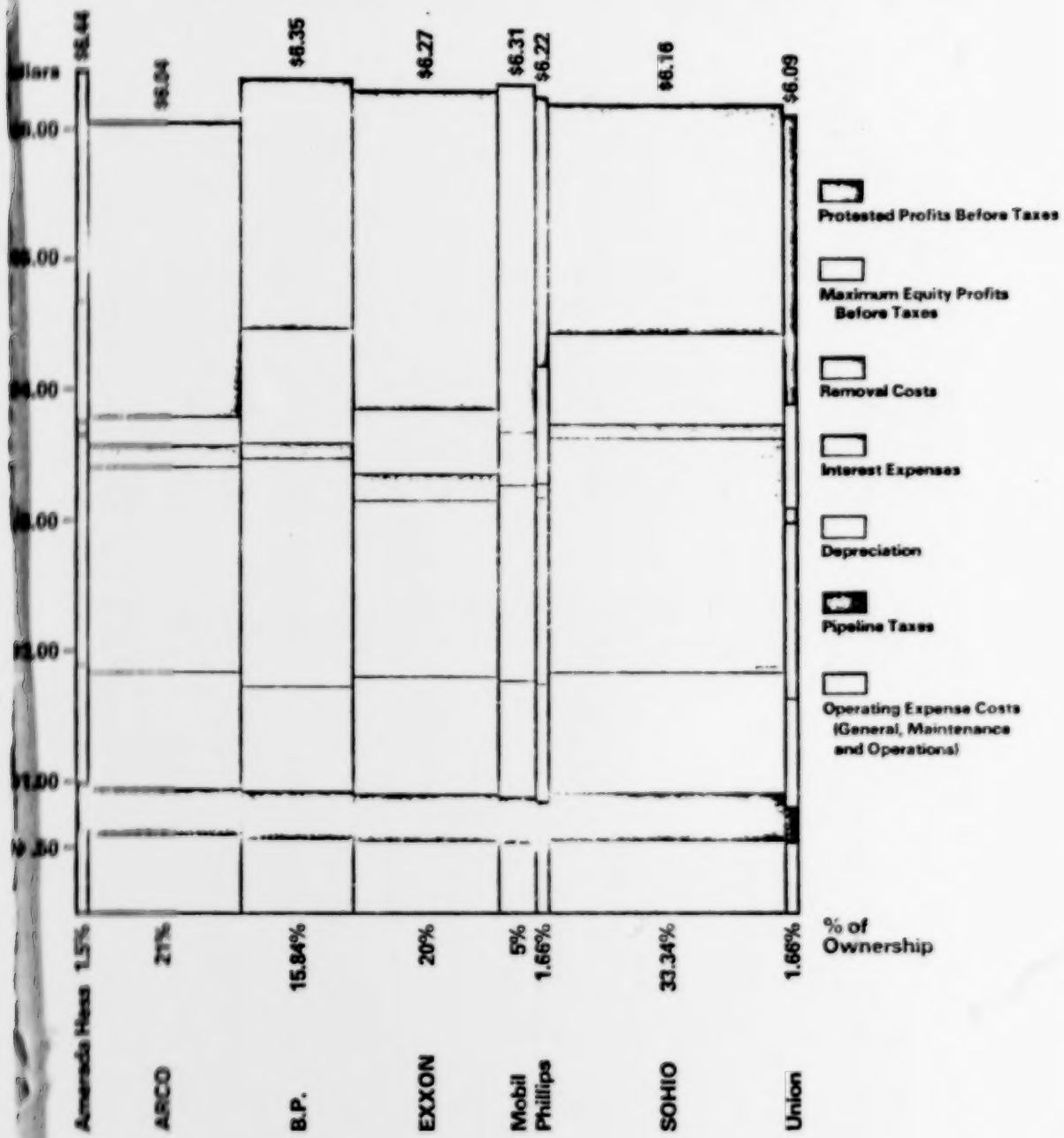
NOTE: Columns may not add due to rounding.

State of Alaska Oral Argument Exhibits, June 27, 1977

[Caption deleted]

PROTESTED TAPS RATES

A Breakdown Analysis of Costs and Profits Per Barrel



PER-BARREL EXPENSES OF TAPS CARRIERS BY SPECIFIC ACCOUNT
(CENTS PER BARREL)

		Alyeska (100%)	Amerada Hess (1.5%)	Arco PL (21%)	BP Pipelines (15.84%)	Exxon PL (20%)
	OPERATIONS					
300	Salaries and Wages	2.10	2.10	2.10	2.10	2.10
310	Supplies and Expenses	1.35	1.35	1.35	1.35	1.35
320	Outside Services	1.24	1.25	1.25	1.24	1.24
330	Operating Fuel and Power	6.51	9.02	14.77	9.02	11.64
340	Oil Losses and Shortages	-	-	-	-	-
	Total Operations	11.20	13.72	19.47	13.71	16.33
	MAINTENANCE					
400	Salaries and Wages	1.51	1.52	1.51	1.51	1.51
410	Supplies and Expenses	.89	.89	.93	1.05	.89
420	Outside Services	17.67	17.67	17.67	17.67	17.67
430	Maintenance Materials	1.97	1.97	1.97	1.81	1.97
	Total Maintenance	22.04	22.05	22.08	22.04	22.04
	GENERAL					
500	Salaries and Wages	4.08	4.07	4.08	5.09	4.53
510	Supplies and Expenses	1.50	1.53	1.54	2.37	1.55
520	Outside Services	5.54	12.90	5.54	6.62	5.70
530	Rentals	1.67	1.67	1.67	1.78	1.70
540	Depreciation and Amortization	-	85.73	83.93	74.95	84.13
550	Pensions and Benefits	1.40	1.40	1.40	1.63	1.53
560	Insurance	.91	1.64	.91	1.88	.91
570	Casualty and Other Losses	-	-	-	.14	-
580	Pipeline Taxes	.52	37.76	37.23	37.95	36.93
	Total General,	15.62	146.70	136.30	132.41	136.97
	(Outside Service Accts. 320,420, 520)	24.45	31.82	24.46	25.53	24.61
	Sub Total: Operating Expenses	48.86	182.47	177.85	168.16	175.34
	OTHER					
650	Interest Expense	2.12	173.94	154.54	171.36	132.83
60	Provision for removal and restoration	-	9.57	14.35	9.57	18.72
	Total Other	2.12	183.51	168.89	180.93	151.55
	GRAND TOTAL	50.98	365.98	346.74	358.09	326.89

PER-BARREL EXPENSES OF TAPS CARRIERS BY SPECIFIC ACCOUNT
(CENTS PER BARREL)

		Mobil Alaska PL (5.%)	Phillips Pet. Co. (1.66%)	SOHIO PL (33.34%)	Union Alaska PL (1.66%)
	OPERATIONS				
300	Salaries and Wages	2.10	2.10	2.10	2.10
310	Supplies and Expenses	3.17	1.35	1.35	1.35
320	Outside Services	1.25	1.24	1.25	1.25
330	Operating Fuel and Power	5.89	6.51	7.19	9.18
340	Oil Losses and Shortages	-	-	-	-
	Total Operations	12.41	11.20	11.89	13.88
	MAINTENANCE				
400	Salaries and Wages	1.51	1.51	1.52	1.52
410	Supplies and Expenses	1.05	.89	.89	.89
420	Outside Services	17.67	17.67	17.68	17.68
430	Maintenance Materials	1.81	1.97	1.98	1.98
	Total Maintenance	22.04	22.04	22.06	22.06
	GENERAL				
500	Salaries and Wages	4.08	4.08	4.12	4.09
510	Supplies and Expenses	1.54	1.54	1.55	1.54
520	Outside Services	7.17	5.89	8.14	6.04
530	Rentals	1.67	1.67	3.34	1.67
540	Depreciation and Amortization	82.55	83.36	86.42	79.08
550	Pensions and Benefits	1.40	1.40	1.41	1.40
560	Insurance	1.82	.91	1.74	.91
570	Casualty and Other Losses	-	-	-	-
580	Pipeline Taxes	37.76	37.75	37.76	37.76
	Total General	137.79	136.60	144.48	132.51
	(Outside Services Accts. 320, 420, 520)	26.09	24.80		24.97
	Sub Total: Operating Expenses	172.24	169.84	178.4	168.45
	OTHER				
650	Interest Expense	149.19	141.37	175.03	132.29
660	Provision for removal and restoration	38.78	9.57	9.59	9.59
	Total Other	187.97	150.94	184.62	142.88
	GRAND TOTAL	360.21	320.78	363.06	310.33

State of Alaska Oral Argument Exhibits

Total TAPS Revenue Providing 8% Return on Valuation

	$Million	Cents Per Barrel (Assumes 438MMB/Y)
1. Operating Expenses:		
a. Other than Depreciation	$408.2	93.2
b. Depreciation (25 yrs.)	371.2	84.7
c. Total Operating Expense	779.4	177.9
2. Removal (25 yrs.)	42.0	9.6
3. 8% Return on Valuation	779.8	178.0
4. Imputed Income Taxes 1/	95.0	21.7
5. Total Revenue Need	1,696.2	387.2
6. Protested/Published Rates	2,715.6	620.0 (avg.)
7. Excess Above ICC Criteria	1,019.4	232.8

1/ Imputed Income Tax Calculation

8% Return After Taxes	779.8
Interest	695.1
After Tax Income	84.7
Imported Income Tax at .5	95.0

State of Alaska Oral Argument Exhibits

Depreciation Expense Changes Depending on Service Life

	Amount ($Millions)	Cents Per Barrel (Assumes 438MMB/Y)
Original Cost	9,280	-
Depreciation Annual Charges/ Recovery: Based on Service Life of		
25 years 1/	371.2	84.7
27.5 years 2/	337.4	77.0
35 years 3/	265.1	60.5

1/ 25 year life urged by TAPS carriers.
2/ 27.5 year life assumed by ICC-BI&E.
3/ 35 year life urged by Alaska as consistent with presently outstanding depreciation Orders Numbered P-187-A (Arco PL); P-148-C (Exxon PL); P-3-E (Mobil PL); P-60-D (Phillips); and P-49-G (Sohio PL). The depreciation rates and related lives for reporting TAPS carriers shown in their Annual Reports are as follows:

Depreciation Rates and Related Life For TAPS Carriers

Pipeline	Average Depreciation Rate	Related Life
Arco Pipe Line Co.	2.34%	42.74 yrs.
Exxon Pipeline Co.	3.36%	29.76 yrs
Mobil Pipeline Co.	2.88%	34.72 yrs.
Sohio Pipe Line Co.	2.73%	36.63 yrs.

THE I.C.C. VALUATION FORMULA

The formula weights the original cost and the cost of reproduction new by their respective percentages of their combined total, multiples that total by the "condition percent", and then increases the result by 6% before adding the present value of land, rights of way and working capital. In a period of inflation, ever increasing weight is given to the inflated cost of reproduction new.

Under the Commission's "valuation" *formula* every dollar of original cost made thirty years ago (i.e. 1947) in a pipeline with a guide-life of 35 years (i.e. expected to last until 1982) would have a "valuation" in 1975 (exclusive of land, rights-of-way, and working capital) of *$1.07.*

A = $1.00
B = $3.43 (1975 Index = 343)
Cp = .35

$$J = \frac{A^2+B^2}{A+B} = \frac{\$1 + \$11.7649}{\$1 + \$3.43} = \frac{\$12.7649}{\$4.43} = \$2.8814672$$

X 1.06

$3,0543442

X .35

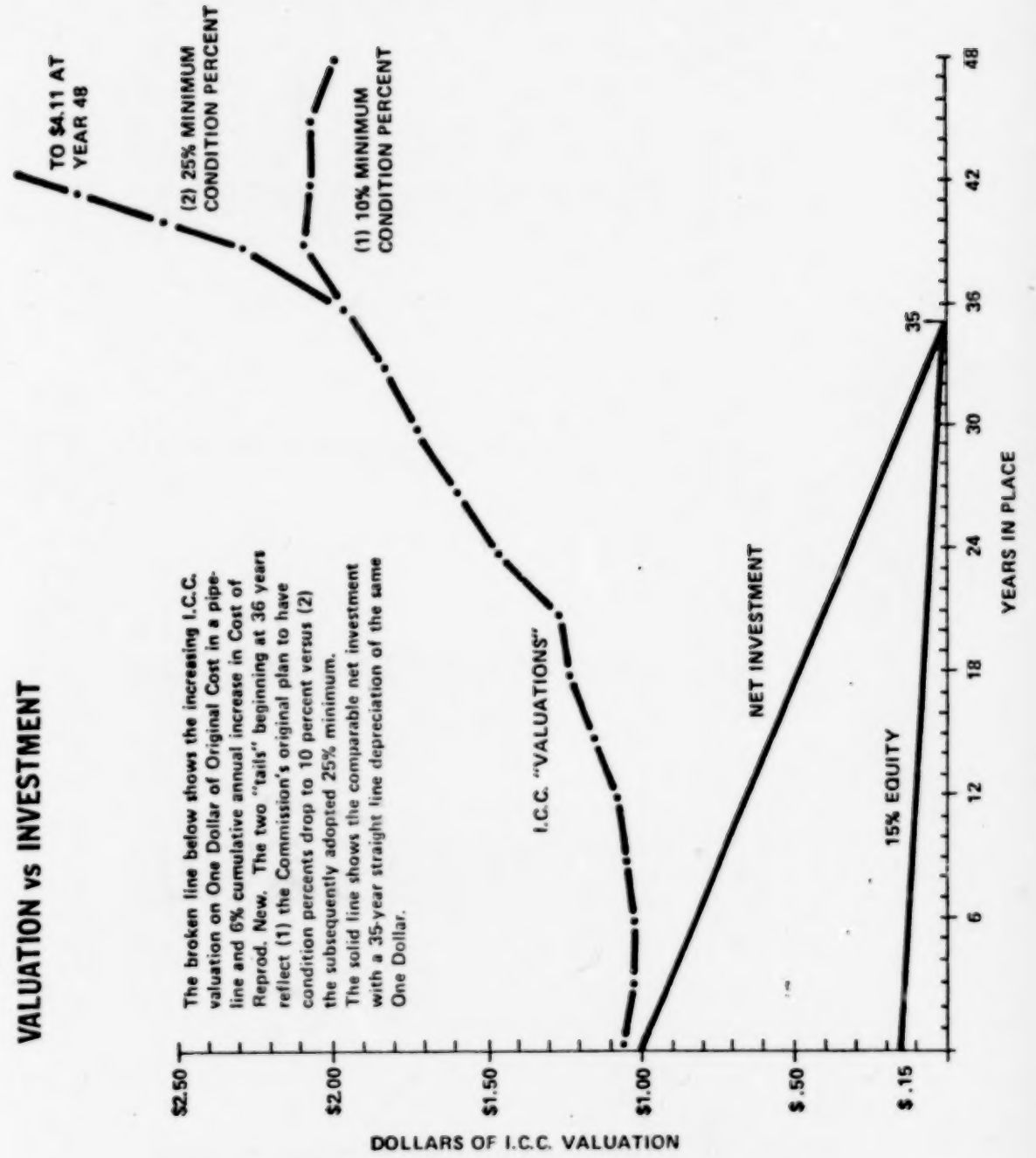
$1.0690243

The investment of $1 twenty-eight years ago would be given a value of $1.07 for the purposes of calculating a return and a permissible dividend payment even though the investor would have received a return of capital through depreciation charges to expenses amounting to 80 cents for each dollar invested. At the end of twenty-eight years in 1975 the investor would only have 20 cents of each original dollar still invested. Yet the Commission's "valuation" would give the pipeline investor a return based on a formula valuation of $1.07.

An eight (8%) or ten (10%) percent return on each such $1.07 of "valuation" would give the investor, the pipeline, a return of 8.56 cents or 10.7 cents, respectively. These represent an *actual return of 42.8% or 53.5%* on the 20 cents actually still invested according to the books of the company.

Where there is a six percent inflation rate the contrast between the I.CC. "valuation" and the net investment rate base (with no values added for land, rights of way and working capital) is as shown on the graph on the following page.

State of Alaska Oral Argument Exhibits



Estimated Pipeline "Valuation" And Return Based On I.C.C. Methodology And Criteria For Each Dollar Of Original Cost

(Inflation Rate of 6% Per Year)

I. 35 Year Life

Year	Cost of Reproduction New 2/ ($)	Condition Percent 3/	Weight of Original Cost 4/	"Valuation" 5/ ($)	8% Return on "Valuation" 6/ ($)
0 1/	1.000	1.00	.50	1.000	.085
1	1.060	.96	.49	1.049	.084
2	1.124	.92	.47	1.039	.083
3	1.191	.88	.46	1.030	.082
4	1.262	.85	.44	1.033	.083
5	1.338	.81	.43	1.025	.082
6	1.419	.78	.41	1.030	.082
7	1.504	.75	.40	1.035	.083
8	1.594	.71	.39	1.027	.082
9	1.689	.69	.37	1.048	.084
10	1.791	.66	.36	1.055	.084
11	1.898	.64	.35	1.078	.086
12	2.012	.61	.33	1.084	.087
13	2.133	.59	.32	1.108	.089
14	2.261	.57	.31	1.132	.091
15	2.397	.55	.29	1.157	.093
16	2.540	.53	.28	1.183	.095
17	2.693	.51	.27	1.208	.097
18	2.854	.49	.26	1.233	.099
19	3.026	.47	.25	1.257	.101
20	3.207	.46	.24	1.308	.105
21	3.400	.44	.23	1.331	.106
22	3.604	.43	.22	1.385	.111

State of Alaska Oral Argument Exhibit

Year	Cost of Reproduction New 2/ ($)	Condition Percent 3/	Weight of Original Cost 4/	"Valuation" 5/ ($)	8% Return on "Valuation" 6/ ($)
23	3.820	.41	.21	1.406	.112
24	4.049	.40	.20	1.461	.117
25	4.292	.39	.19	1.517	.121
26	4.549	.37	.18	1.533	.123
27	4.822	.36	.17	1.590	.127
28	5.112	.35	.16	1.647	.132
29	5.416	.33	.16	1.655	.132
30	5.743	.32	.15	1.710	.137
31	6.086	.31	.14	1.765	.141
32	6.453	.29	.13	1.759	.141
33	6.841	.28	.13	1.809	.145
34	7.251	.27	.12	1.858	.149
35	7.686	.26	.12	1.906	.152
36	8.147	.25	.11	1.952	.156
--					
40	10.286	.21	.09	2.106	.169
--					
50	18.420	.10	.105	1.857	.149

1/ For year zero, the original cost and the cost of reproduction new are the same.

2/ Original cost estimated at one dollar increased at an annual inflation rate of six (6%) percent as estimated cost of reproduction new.

3/ Condition percent is the ratio (%) of the cost of reproduction new less depreciation to the cost of reproduction new. For the purposes of this estimate the condition percent shown for pipe and fittings with a guide life of 35 years was used as shown in the January 1959 ICC publication entitled "Pipeline Condition Percent Table for Additions and Betterments." (Ex 33A, p.3)

4/ Weight given the original cost under the I.C.C. estimated formula.

5/ Valuation:

$$V = \left[A\left(\frac{A}{A+B}\right) + B\left(\frac{B}{A+B}\right)\right] Cp. \times 1.06$$

or $$V = \left(\frac{A^2+B^2}{A+B}\right) Cp. \times 1.06$$ (no value added for land, right of way or working capital)